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LETTERS OF CREDIT: THE NEED FOR UNIFORM LEGISLATION*

SOIA MENTSCHIKOFF†

OF RECENT YEARS, largely as a result of opposition by a few New York banking counsel to the inclusion in the Uniform Commercial Code of an article on documentary letters of credit, a number of myths have arisen and by virtue of constant repetition by this small but vocal group have obtained considerable credence.¹ This paper will examine the nature and validity of these myths:

Myth 1.—Practices and customs as to international documentary letters of credit are uniform

- (a) among nations
- (b) among banks in this nation.

Myth 2.—The law of letters of credit has become

- (a) clear
- (b) well settled
- (c) known to bank, merchant, bar and bench
- (d) uniform among states
- (e) probably uniform among nations.

Myth 3.—Domestic use of letters of credit is and will remain non-significant.²

* This paper is not written in my capacity of Associate Chief Reporter of the Uniform Commercial Code. It represents only my personal views and not those of the sponsoring organizations. I am indebted to Karl N. Llewellyn for critical reading of the paper and especially to Jean Allard, Research Associate, Commercial Arbitration Project, University of Chicago Law School, for both research and editorial assistance.

† Professorial Lecturer, University of Chicago.

¹ Consult memoranda and testimony presented before New York Law Revision Commission at the Public Hearings on Article 5, April 20, 1954. N.Y. Law Revision Comm'n Study of Uniform Commercial Code, Leg. Doc. No. 65 (D) (1954).

² Even so myth-resistant a group as the New York Law Revision Commission has found that there was no need for codification of letters of credit because, "Most letter of credit transactions, moreover, take place in international trade. The desirable objective of uniformity, both nationally and internationally, is now obtained to a high degree by decisional

INTERNATIONAL "UNIFORMITY"

The basic fact on which the claim of international uniformity of custom and practice rests is the existence of a document entitled "Uniform Customs, and Practices for Commercial Documentary Credits fixed by the Thirteenth Congress of the International Chamber of Commerce."³ This document despite its name is not a statement of "Customs" and "Practices";⁴ about 40% of its content is devoted to an attempt to describe legal relations among the parties to a letter-of-credit transaction and especially to disclaim various kinds of liability which might be imposed upon the banking parties. The balance does purport to state practices or customs, but this statement is not necessarily based on existing practice; it is at least in part a statement of what the draftsmen thought a practice ought to be.⁵ There is nothing to criticize in this attempt at creation of uniformity of practice by way of agreement; on the contrary, such an attempt is worthy of great encouragement, but it must never blind us to the fact that a statement of what a custom ought to be is not a legal substitute for a finding of what the custom is.⁶

Before considering further the contents of this document, it is important to ascertain the extent of its adoption by nations and banks. It has been adopted by no nation nor has it formed the basis of any convention, treaty or executive agreement. Its legal value, if any, rests entirely either on the extent to which it has been effectively made a part of all of the separate contracts involved in a letter of credit transaction⁷ or does describe a practice which is uniform in fact.⁸

The most recent report by the International Chamber of Commerce of bank adherence to the "Uniform Customs" is as of January 1, 1956. There were three types. The first type is "official collective adherence by vote of professional associations." This means that the relevant bankers' association in a particular nation in a particular meeting has voted to adhere, but any actual practice re-

law and commercial usage." N.Y. Report of the Law Revision Commission to the Legislature Relating to the Uniform Commercial Code, Leg. Doc. No. 65 (A) 63-64 (1956) (mimeo.).

³ Brochure, No. 151, International Chamber of Commerce.

⁴ Custom in dictionary terms means "a habitual practice; the usual way of acting in given circumstances" or "a long-continued habit which is so established that it has the force of law." Practice is "habitual or customary performance." Am. College Dict.

⁵ Ward and Harfield, *Bank Credits and Acceptances* c. 12 (3d ed., 1948) (hereinafter referred to as Ward and Harfield); consult also short history given by Mr. Horace M. Chadsey, Vice-President, First Nat'l Bank of Boston, at the Public Hearings on Article 5, N.Y. Law Revision Comm'n Study of Uniform Commercial Code, Leg. Doc. No. 65 (D) 57 (1954). Consult also the changes in the revised document adopted in 1951, discussed in *Revised International Rules for Documentary Credits*, 65 Harv. L. Rev. 1420 (1952).

⁶ *Dixon, Irmaos & Cia. v. Chase Nat'l Bank*, 144 F. 2d 759 (C.A. 2d, 1944), cert. denied 324 U.S. 850 (1945), illustrates the difference.

⁷ As to this, there is a real problem of incorporation by reference; consult text *infra* at notes 80-84.

⁸ The legal requirements are discussed in *Custom and Trade Usage*, 55 Col. L. Rev. 1192 (1955).

mains, of course, a matter of the actions of individual parties to particular contracts. The United States by virtue of the action taken by the Bankers' Association for Foreign Trade is a nation which has this type of adherence. The second type of adherence is "official individual adherence of certain banks."⁹ Obviously, this second type of adherence is less likely to produce uniformity than adherence of the first type. The third type of adherence is called "tacit collective or individual adherence." In prior reports third-type nations were reported under the head "adherence is supposed but has not yet been confirmed." However the third type of adherence be described,¹⁰ it seems the least likely to produce international or national uniformity.

Before considering what effect on national uniformity the first type of adherence has, it should be noted how few are the nations both by number and by their importance to American foreign trade which have given this first type of adherence. In 1954, the total volume of exports from the United States was \$15,076,787,000. For security reasons \$2,863,709,000 of this amount cannot be identified as to country of destination. Of the remaining \$12,213,078,000 exports, only \$3,767,188,000 or 30.8% was to countries adhering in type-one fashion. \$2,057,608,000 or 16.8% additional was to countries where at least one bank had adhered. A final \$724,594,000 or 5.9% was to countries whose adherence is "tacit."¹¹ As can be seen this means that 46.5% of our total exports was to countries where no adherence of any kind whatsoever exists to the so-called "Uniform Customs," and that almost exactly 70% went to countries where adherence is either non-existent or not uniform.

The import picture is even more discouraging on adherence. Of a total of \$10,207,729,000 only \$2,489,750,000 or 24.3% originated in countries adhering by way of relevant bankers' associations. \$1,813,192 or 17.7% additional originated in countries where one or more individual banks have adhered and \$768,810,000 or 7.5% in countries where there is tacit adherence.¹² In other words 50.5% of our total imports is from nations in which no one is counted as adhering in any way to the "Uniform Customs" and over 75% is from countries where adherence is either non-existent or not uniform.

So far as exports are concerned, American banks will typically be advising or confirming banks acting at the request of foreign issuing banks.¹³ Advising a credit as embodying the "Uniform Customs" without instructions to do so

⁹ The nations listed in this category are for the most part nations in which American banks maintain branches. (Ten of the fourteen nations listed for this type of adherence are Central or South American countries.) Query, therefore, whether this class is not in major measure a part of American adherence.

¹⁰ I assume that the Commission on Banking Technique and Practice which met January 26 and 27, 1956, to go over this report prior to its public issue preferred the perhaps less accurate but more interesting phrasing now in use.

¹¹ 1955 Statistical Abstract of the United States 916-21.

¹² *Ibid.*

¹³ If the American bank issues at request of foreign buyer, all is clear.

from an issuing bank located in a non-adhering nation raises troubling issues. The first question is whether or not the American bank has exceeded its authority in so doing and has thus become liable to its principal, the issuing bank. This would seem to require answer in the affirmative.¹⁴ The next question is as to the rights of the beneficiary. Frequently the law of the issuer's nation imposes more rigorous requirements on him than would the terms of the "Uniform Customs"; the English courts, for instance, read ocean "bill of lading" as requiring not merely the "received for shipment" bill of the "Customs," but an "on board" bill. Where an English credit is advised by an American bank calling for "ocean bill of lading, S.S. Maria," and "subject to" the "Uniform Customs" the answer probably depends on the law of the nation in which the issuing bank is domiciled. Under common law, the apparent agency of the American bank would probably bind the English issuer but leave it with an eventual action over against the American bank.¹⁵

The import problem is the reverse of the export problem. The American bank becomes the issuer and its problem becomes that of receiving papers which are non-complying under its own understanding but perhaps permissible in the country from which the goods were shipped.¹⁶ If the issuing bank is forced to pay on a theory of apparent agency, it still leaves open the question whether it can require reimbursement from its customer under these circumstances.¹⁷

NATIONAL "UNIFORMITY"

The United States is an adhering nation of the first type, that is to say, the Bankers' Association for Foreign Trade has voted to adhere. In addition an extensive educational drive for adherence was made among American bankers by the BAFT's Committee on Uniformity in Documents and Practices in the latter half of 1951 and sporadically thereafter. After a few drafting difficulties,¹⁸ the Committee circulated two clauses which appear directed at two divergent lines of interpretation with regard to the meaning of various terms. The first clause seems to resolve the conflicts between provisions of the "Customs" and those of the American Foreign Trade Definitions in favor of the latter; the second clause seeks to disregard and pro tanto supersede the American Foreign

¹⁴ Compare *Gidden v. Chase Nat'l Bank*, 82 N.Y.S. 2d 341 (1948).

¹⁵ See Rest. of Agency §§ 159, 162, 172; Davis, *The Law Relating to Commercial Letters of Credit* 94 (1939); Gutteridge, *Banker's Commercial Credits* 51 (1932).

¹⁶ Consult, e.g., insurance currency variations discussed in Ward and Harfield 192; or British reservations, *ibid.*, at 195.

¹⁷ Banks attempt to solve the problem of reimbursement by two clauses which recur in their individual forms. One is the counterpart of Article 10, paragraph 1 of the "Uniform Customs." The other reads: "as to drafts or acceptances under or purporting to be under the credit. . . ."

¹⁸ The original suggestion was that each credit "except as otherwise stated" be made "subject to" both the "Uniform Customs" and the American Foreign Trade Definitions-1941. Since the two documents are in conflict on a number of points, this would have created confusion. It was fortunately caught before it had circulated too long and the clauses in the text became the official ones. One bank does have the clause as originally suggested.

Trade Definitions and any mercantile practice in consonance with them. The clauses read:

Except so far as otherwise expressly stated, this credit is subject to the Uniform Customs and Practice for Commercial Documentary Credits fixed by the Thirteenth Congress of the International Chamber of Commerce; for the definitions of certain export quotations reference is made to the general descriptions of those terms included in the "Revised American Foreign Trade Definitions, 1941."

Unless otherwise expressly stated, this credit is subject to the "Uniform Customs and Practice for Commercial Documentary Credits fixed by the Thirteenth Congress of the International Chamber of Commerce."

It will be noted that both suggested clauses refer to "otherwise expressly stated." When one of the suggested clauses of incorporation is used a problem is presented of putting together the particulars of the forms used by individual American banks and the terms of "Uniform Customs" in an effort to discover what the total provisions of any given bank's forms amount to. Obviously, to the extent that the individual forms vary, the total meaning of the credit varies and non-uniformity results.¹⁹

This problem is quite independent of the legal problem of whether and to what extent all or particular provisions of the "Uniform Customs" are valid as against merchants (the customers and beneficiaries). This group had no part in the drafting of these "Customs" which purport to state how merchants as well as banks behave and should behave.²⁰ The legal problem rests in part on the fact that most merchants can say in all honesty "I never saw this document in my life and did not know its contents when I signed the application for the credit or when I received the credit."²¹

In 1955 and 1956 I obtained a sampling of forms currently being used by American banks²² on all three seaboards and in the interior for the purpose of

¹⁹ I am not talking here about typewritten insertions at the request of customer. Obviously, such changes are contemplated by the "Uniform Customs," all of which I take to be subject to agreement otherwise. I am talking about differences in the form "boiler-plate" which is intended, like the "Uniform Customs," to be the rule unless "expressly stated otherwise."

²⁰ The following is an illuminating description of merchant participation: "In this connection it might be said that the manner of preparing these revisions can hardly be entirely satisfactory to exporters. At an early stage in the proceedings exporters are given an opportunity to present their views; in fact, they are even encouraged to do so. In some cases their views are accepted. But when it comes to the showdown, the final revisions are discussed by bankers, with their attorneys, behind locked doors, and exporters have no chance whatever. When the compilation is published, the exporter may find that one of the provisions he worked for, and which he confidently expected would be included, is omitted." Editorial, 64 Export Trade and Shipper 14 (Sept. 17, 1951).

²¹ A material fact under *Matter of Bachmann, Emmerich & Co.*, 204 App. Div. 282, 197 N.Y.S. 879 (1st Dep't, 1923). Banks which are aware of this legal difficulty have printed brochures which include the "Uniform Customs" and which are supposedly given to every customer on or before the signing of the customer's agreement.

²² Although it is highly likely that New York banks do from 40% to 50% of the total documentary letter-of-credit business in foreign trade, it must not be overlooked that the rest of

showing students the kind of clauses banks were interested in. Before discussing the results of this sampling as it bears on the question of uniformity of national practice, it is important to point out who the relevant contracting parties are in a letter-of-credit transaction. Normally, the documentary letter of credit is based upon and reflects a sales contract.²³ It is the medium by which the buyer pays for the goods purchased.²⁴ The buyer is always the "customer" on whose behalf the "issuing" bank opens the letter of credit.²⁵ The seller is the person who as the beneficiary of the credit will draw on the issuing bank to receive his payment. Basically speaking the transaction, therefore, involves two merchants and a bank. Normally, of course, the bank will use other banks to "advise"²⁶ or "confirm"²⁷ the credit. Sometimes the issuing bank will deliver the letter evidencing the credit to its own customer for transmission by him to the beneficiary. As can be seen, therefore, the following contracts are typically involved: (1) contract between the issuing bank and its customer under which the bank opens or issues the letter; (2) contract between the issuing bank and the beneficiary which is the letter of credit itself; (3) contract between the issuing bank and the correspondents it uses to advise or confirm the credit in a communication which is the means by which the beneficiary acquires notice of the issuance and terms of the letter; (4) contract between the confirming bank and the beneficiary which is really a second and additional letter of credit.

Underlying all of these contracts is the reason for them all: the sales contract between the customer and the beneficiary. From the point of view of these merchants the issuance and honor of the letter are acts of performance by the buyer, the sufficiency of which is to be measured by the sales contract. In other words, although banks are rightfully primarily concerned with the legal implications of the contracts other than the sales contract, it must never be forgotten that the letter of credit is in origin and operation first of all an instrument serv-

our banks do a large amount and that their practices are, therefore, equally significant. Actually at the hearings before the New York Law Revision Commission only several billions of letter-of-credit business was claimed by New York, which would be a mere 15% to 20% of our total foreign trade, but I think the figure is higher.

²³ This is recognized in Article 1 of the "Uniform Customs."

²⁴ It serves two functions as a payment medium: it adds the bank's reputation and obligation to pay to the buyer's thus making the seller more secure and it assures any necessary translation of dollars into other currency and vice versa, an important consideration today. See *Bril v. Suomen Pankki Finlands Bank*, 199 Misc. 11, 97 N.Y.S. 2d 22 (S. Ct., 1950), *aff'd* 101 N.Y.S. 2d 256 (App. Div., 4th Dep't, 1950). It has other functions of a financing nature which are discussed *infra*.

²⁵ The "applicant for the credit" in "Uniform Customs" terms.

²⁶ An "advice" of credit means only that a bank in the seller's country informs ("advise") him that a named bank in the buyer's country has issued a credit in his behalf on the terms stated in the advice. There is no promise by the advising bank itself to honor drafts.

²⁷ A bank which "confirms" a credit gives the information set forth *ibid.*, and then itself promises to honor drafts drawn under the credit.

ing a mercantile function and that the most fundamental inquiry about its utility is how well it serves that function. As is developed later, the draftsmen of the "Uniform Customs" perhaps because of their preoccupation with the slogan of non-concern with the sales contract,²⁸ have lost sight of this fundamental truth, a truth which the British banker has always understood,²⁹ and which perhaps explains his continued refusal to adhere in any way to the "Uniform Customs."

In view of the method by which the "Uniform Customs" are sought to be incorporated into the letter-of-credit transaction,³⁰ the real test of uniformity in the United States turns on what the individual bank forms provide with regard to matters also covered by the "Customs." Before dealing with a few selected areas here, let us make an initial check of how many banks use the clauses suggested by the BAFT Committee or refer to the "Uniform Customs" in any other way. The truth is that there is no uniformity of American bank action even on this purely formal level.

Requests for forms were sent to 42 banks selected for variation in geographical locale and size.³¹ 4 of these failed to respond. 5 stated that they either had no special forms or used forms provided by other banks.³² One refused to supply forms. The analysis here is of the forms supplied by 32 banks.³³ Since the forms analyzed are overweighted in favor of California, New York City and Chicago, no generalizations as to variance among all banks can be made in statistically significant terms. The fact of non-uniformity does emerge however.

15 banks use differing "export" and "import" credit forms. Although several banks also offer special forms for other forms of credit, such as the "authority

²⁸ Article 1. "Commercial documentary credits are essentially distinct transactions from sales contracts, on which they may be based, with which Banks are not concerned." All this slogan really means is that banks by issuing a letter of credit assume no responsibility for performance of the sales contract.

²⁹ ECA, Tech. Assist. Div., Discussion of Projected Program for Classification of International Banking Practices (Minutes) (OECC No. 31, 1951). Rice and Thorne, *The Uniform Customs and Practice for Commercial Documentary Credits*, 56 *Canadian Banker* 53 (1949): "Yet the practice must first be set up by the trader, not the banker, and it will be found that banking and the law will adjust themselves—easily, as I think—to the changing requirements of practice, for the simple reason that it is the function of the banker to serve his customer, and of the law to give effect to the intentions of the parties as evidence of their written contract and their customary behaviour." *Ibid.*, at 61.

³⁰ It is to be remembered that the incorporation clause starts out "Except as otherwise stated."

³¹ Of the 42 banks surveyed there were: 11 Eastern, 20 Midwestern, 9 Western, 2 Southern. By national size according to total deposits there were: 16 among the first 25, 6 among the second 25, 4 among the third 25, 6 among the second 100, 4 among the third 100, 6 below the top three 100.

³² The other banks named were Chicago and New York banks.

³³ This includes 3 banks which sent only customer application forms. The forms are all on file with the Commercial Arbitration Project of the University of Chicago and may be examined there.

to purchase or pay"³⁴ and the "revolving" credit,³⁵ to keep the analysis relatively manageable, it is restricted to the forms which are either "export" or "import" or reported as *the* form without regard to the export or import nature of the transactions. Almost all banks reported that "revocable" credits were virtually unknown. Five banks included forms for such credits. Basically speaking, therefore, the forms are those used for "irrevocable" credits.

Customers' applications for issuance of the letter of credit appear either on the reverse of a copy of a credit or in a separate instrument. If in the separate instrument, that instrument typically refers to issuance of the credit in "your usual form." Although this type of reference creates some doubt as to whether a customer knows what the "usual form" is, the assumption here is that he does and therefore has consented to the terms in the "usual form."

The beneficiary of the credit does not see nor does he know the conditions of the customer's application. To the extent that the terms of the application define language in the credit in a way differing from that in the "Uniform Customs" (if those be referred to in the letter of credit) the beneficiary has no knowledge of the difference.

With 3 exceptions, no one of the customer applications or agreements specifically refer to the "Uniform Customs." If these are incorporated at all, therefore, it is by reference to "your usual form" or by appearing on the face of the credit, the second copy of which contains the customer's agreement on the reverse side.³⁶

On the credits themselves, of the 17 used without differentiation as to "export" or "import" only 2 even mentioned the "Uniform Customs." Of the 15 banks using import credits, only 5 mentioned the "Uniform Customs." Of the export credits, all but 1 bank mentioned the "Uniform Customs." Only 5 banks using both "export" and "import" credits failed to distinguish between them in mentioning the "Uniform Customs." Three of these were New York City banks; 1 was a Massachusetts bank; and 1 was a California bank. The non-uniform use of the "Uniform Customs" is not dependent on size. Of the 9 of the 10 largest banks in the country whose forms were analyzed, 4 completely failed to mention the "Uniform Customs"; 2 do so for "export" credits alone, while only 3 use them for both kinds of credit. The "Uniform Customs" do not seem to have met with uniform adherence. This means that on the national level, as on the international, the problem of conflict of interpretation and understanding continues to exist since banks in one part of the country can and do ask banks in other parts of the country to either issue or advise credits.³⁷ In this connection,

³⁴ Ward and Harfield 163 urge that this is the proper form for what is called a "revocable" credit.

³⁵ Consult Ward and Harfield 31, for definition of "revolving" credits.

³⁶ Incidentally, I do not believe my eyes are abnormally bad, but in case after case, the fineness of the print makes the agreement a document almost impossible to read.

³⁷ See e.g., the factual situation in *Kingdom of Sweden v. New York Trust Company*, 197 Misc. 431, 96 N.Y.S. 2d 779 (S. Ct., 1949). Consult text at note 127 *infra*.

it is interesting to note that 11 of the banks, including all New York banks in our sample, specifically provide in the customer application that the laws of their own jurisdictions shall operate (a practice which the much criticized Section 1-105 of the Code would authenticate beyond doubt) and 8 of the banks specifically provide for the binding effect of action taken pursuant to foreign laws or customs (an intelligent term which takes full cognizance of the existing non-uniformity of practice and understanding on the international scene). The "Uniform Customs" provide that "applicants for the credit are responsible to the banks [presumably including the bank taking action] for all obligations imposed upon the latter by foreign laws and customs."

Detailed points of difference between the "Uniform Customs" and the individual bank forms are considered under the various sub-heads of this paper, but a few recurrent ones not there discussed should be mentioned here.

The "Uniform Customs" in Article 20 quite properly state that bills of lading issued by freight forwarders will be refused unless specifically authorized. Yet 21 of the individual bank customer forms define bill of lading as including "documents issued or *purporting to be issued* by or *on behalf of* any carrier. . . ." (Italics added.) This would seem to include a freight forwarder's bill. If such a bill is presented under such circumstances, which clause is controlling? The "Uniform Customs" are always incorporated by a provision of "Except as otherwise stated" or the like. The "otherwise" statement is not in the credit but yet the credit is incorporated in the customer's agreement. Assuming the beneficiary has no right to payment or acceptance, if the issuing bank does pay or accept, is the customer under a duty to reimburse it? That duty is typically defined in the credit in language indicating that drafts and documents are to be honored "under the credit." Under a strict rule of construction,³⁸ I take it, the customer would be under no duty to reimburse the bank.³⁹ Incidentally, to the extent that liability provisions are set up in an exculpatory or disclaimer form, the same strict rule of construction would lead to an absence of duty to reimburse since such provisions, strictly construed, are mere defenses to actions against the issuer and no substitute for acquiring documents which comply with the credit.

Another place of real divergence, this time with the individual bank forms being in line with commercial understanding, is on the point of insurance coverage. Article 30 of the "Uniform Customs" provides:

Failing instructions as to the risks to be covered or when a credit stipulates that insurance cover "usual risks" or "customary risks" or insurance requirements of similar import, banks may accept insurance documents as tendered without responsibility on their part.

8 of the bank forms provide that coverage must include marine and war risks and 18 more provide for check marks as to this. The acceptance of insurance,

³⁸ Forms in such fine print deserve to be strictly construed against the issuer.

³⁹ Some forms add "purporting to be" under the credit. The result here might be different.

in an overseas transaction, without check by the issuing bank for at least these two risks, would go a long way towards establishing lack of "good faith."

There are also minor differences between the banks and the "Uniform Customs" as to liability for translation of foreign or technical terms and the right to "waive insurance papers on proof satisfactory to them [the banks] that the insurance is covered."⁴⁰ The banks in the latter case seem to feel that the customer has to instruct as to who will effect insurance, and I cannot believe that this requirement would be subject to waiver since every single one of the banks requires that the person to effect insurance be filled in by the customer. The same prominent treatment is given by 22 banks to the right to accept partial shipments,⁴¹ an example of overdrafting in the "Uniform Customs" which is discussed *infra*.⁴²

There is also a difference in the subjects covered by the forms and the "Uniform Customs." There is no criticism to be made of the non-coincidence of coverage, but, if we are examining uniformity of national practice, two areas of non-uniformity should be noted. The first lies in the provisions as to freight.⁴³ Only 5 banks give the customer the option of checking "prepaid" or "collect." The rest of the banks are silent on this point. These days the mercantile understanding in an overseas transaction is that it must be prepaid or provided for whereas the case law permits collect shipment.⁴⁴ The matter is of considerable practical importance in this era of controlled currency because the provision plays a major part in determining the currency in which freight will be paid. Clearly some uniform practice ought to be adopted in this area.

The second area of non-uniformity of practice among banks, not touched by the "Uniform Customs" is the form in which the bill of lading is to be presented. Nine banks specifically require that it be issued in their names. Five require that it be issued in "shipper's name, blank endorsed." The rest are silent or give an option for the customer to check. The incongruity of the first type of clause in a negotiation credit is discussed *infra*.⁴⁵ It is sufficient to note here the absence of uniformity.

The first myth of international and national uniformity of practice and understanding, I submit, is more false than true. As Mr. Horace Chadsey, President of the Bankers' Association for Foreign Trade, testified at the hearings before the New York Law Revision Commission the "Uniform Customs" are not uniform and "honored in the breach in a good many instances."⁴⁶

⁴⁰ Article 15 of the "Uniform Customs."

⁴¹ Article 36 of the "Uniform Customs."

⁴² Consult text at notes 161-65 *infra*.

⁴³ The "Uniform Customs" merely define what is acceptable as proof of payment of freight (Article 17).

⁴⁴ Section 2-320(2)(b) of the Code; American Revised Foreign Trade Definitions, 1941. See *Dixon, Irmaos & Cia. v. Chase Nat'l Bank*, 144 F. 2d 759 (C.A. 2d, 1944).

⁴⁵ Consult text at note 113 *infra*.

⁴⁶ N.Y. Law Revision Comm'n Study of Uniform Commercial Code, Leg. Doc. No. 65 (D) at 73 (1954).

The position of Mr. Wilbert Ward, Chairman of the Inco Committee which drafted the "Uniform Customs," sponsor and creator of the whole concept of uniformity and acknowledged international authority on the law⁴⁷ and practice of documentary letters of credit,⁴⁸ on the need for uniform statutory treatment is well in point.⁴⁹ He concluded that after 35 years of continuous effort for uniformity by conference, the goal remained unreachd. It is time for uniform legislation to step in to help the situation.

THE "UNIFORM" LAW OF LETTERS OF CREDIT

As has been indicated the "Uniform Customs" are not limited to an attempt to state existing behavior by banks with respect to documentary credits. A great deal of the document is given over to statement of what can best be described as rules of liability. Some of these, I assume unintentionally, can lead to results which are both contrary to better case law and which in addition would be bad for continued growth of the use of documentary credits. I shall consider the relation of various provisions of the "Uniform Customs" to the problems of (1) the insolvency of an issuing or confirming bank, (2) the establishment and validity of revocable and irrevocable credits, (3) the allocation of risks of negligence or other fault of banks and third parties, (4) some special problems of negotiation credits, (5) the transferability of a credit for further use in financing by the beneficiary and (6) the compliance of documents with the credit, including here the problem of reimbursement of the issuing bank by the customer.

Insolvency of Issuing or Confirming Bank

Obviously wherever there are two banks obligated on the credit, as in the situation where there is not only an issuing bank but also a confirming bank, the insolvency of a single one of these banks is not too serious a matter so far as the customer and the beneficiary of the credit are concerned because the remaining bank will pay the credit.⁵⁰ The important aspect of insolvency is when the issuing bank becomes insolvent and there is no confirming bank to take up the slack. The "Uniform Customs" nowhere deal explicitly with the problem of insolvency. However, in the general provisions there is a statement of a rule—supposedly a rule of law—which runs as follows: "The beneficiary of a credit can in no case avail himself of the legal relations existing between

⁴⁷ Consult Ward, *American Commercial Credits* (1922) and subsequent revisions in Harfield (1931) and with Harfield, *Bank Credits and Acceptances* (1948).

⁴⁸ Vice-President of the National City Bank of New York from 1923 to 1950.

⁴⁹ Ward and Rosenthal, "The Need for the Uniform Commercial Code in Foreign Trade," 63 Harv. L. Rev. 589 (1950); N.Y. Law Revision Comm'n Study of Uniform Commercial Code, Leg. Doc. No. 65 (J) 112 et seq. (1955).

⁵⁰ The prime mercantile reason for a "confirmed" credit is to have a bank committed to honor in the seller-beneficiary's own country. The same thing can be accomplished by requiring issuance of the credit by a bank in the seller's country. This normal reason is today complicated by currency restrictions. See, e.g., *Bril v. Suomen Pankki Finlands Bank*, 199 Misc. 11, 97 N.Y.S. 2d 22 (S. Ct., 1950), aff'd 101 N.Y.S. 2d 256 (App. Div., 4th Dep't, 1950).

banks, or between the applicant for credit and his bank."⁵¹ I assume that the effort here was to provide against interference by the beneficiary with the ordinary working out of the total transaction and that the purpose is to keep action and instructions limited to channels as in the case of a collection agency running through a sequence of banks. But the provision shows no such limitation on its face. It seeks to shackle the beneficiary in every case, including that of the issuing bank's insolvency. But such an insolvency, as the case law shows, forces to the fore the true relation of the documentary credit to the movement of merchandise; and any application of the language quoted from the "Uniform Customs" would lead to most unhappy results. The Uniform Commercial Code rule on insolvency which appears in Section 5-117 is in contrast the rule which is deemed most desirable for the purpose of accelerating the growth and utility of the documentary credit by and for the mercantile community.⁵² The only jurisdiction in the country in which it is even arguable that this desirable result exists on the case law is New York. The relevant cases are *Bank of U.S. v. Seltzer*,⁵³ *Greenough v. Munroe*⁵⁴ and *Shawmut Corp. v. Bobrick Sales Corp.*⁵⁵ In the *Seltzer* case, the issuing bank's representative in insolvency sought to enforce against the applicant for the credit (the buyer-customer) its right to payment on a draft which had already been accepted under a letter of credit. The draft had been accepted prior to the insolvency of the bank. The accepted draft was presented for payment by a bank holder in due course. Payment was refused on the ground that the bank was in the hands of the Superintendent of Banks and was not open for business. The draft was thereupon duly protested for non-payment. Subsequently the defendant customer paid the draft "for honor supra protest" proceeding under the Negotiable Instruments Law.⁵⁶ The plaintiff issuing bank claimed that notwithstanding its failure to pay the draft it nonetheless had the right to recover the amount promised by the customer in its application for a letter of credit, whereas the holder of the accepted draft was at best a general creditor of the issuing bank like all other holders of accepted drafts, and should receive a general creditor's pro rata distribution of the bank assets. The theory of the position, like that of the "Uniform Customs," is the complete separability of the contracts involved in a letter-of-credit transaction. But the court held that the issuing bank's failure to pay constituted a failure of consideration for the contract between the customer and the issuing bank and that hence there was no obligation due from the customer to the plaintiff bank. The two contracts were thus knit together in one very important

⁵¹ This is paragraph 3 of the General Provisions. The Uniform Customs which were operative prior to 1951 did not contain this provision. See Ward and Harfield 208, et seq.

⁵² *Ibid.*

⁵³ 233 App. Div. 225, 251 N.Y. Supp. 637 (1st Dep't, 1931).

⁵⁴ 53 F. 2d 362 (C.A. 2d, 1931).

⁵⁵ 260 N.Y. 499, 184 N.E. 68 (1933).

⁵⁶ Consult Uniform Negotiable Instruments Act §§ 161-77.

aspect. The court did not pass explicitly upon the question of whether a holder of a draft accepted under the credit had become entitled to preferential payment of the draft. It is interesting to note also that although the court did not pass on the validity of the procedure, the customer in this case had offered to pay the amount due to the issuing bank in trust for the payment of the particular acceptance and that this offer had been refused.

In the *Greenough* case a buyer-customer had again procured issuance of a documentary letter of credit; drafts drawn thereunder had again been accepted; the accompanying documents had again been released to the buyer-customer against trust receipts recited to secure those acceptances, and the clause securing "all other obligations" was again inapplicable because there were no other obligations. The buyer-customer filed a petition asking leave either to redeem trust receipts by exhibiting to the receiver proof of its payment of the accepted drafts, or, in the alternative, that it be permitted to pay the money to the receiver under express trust for the payment of the respective accepted drafts. In this case the Court developed the *Seltzer* rule that the insolvent bank, after repudiating payment of drafts accepted under a documentary credit, was not entitled to collect from the customer indemnity to cover those acceptances, by ruling that the issuing bank could not complain of a decree impressing upon the sums to be paid by the buyer-customer a trust in favor of the holders of the respective acceptances. In view of the specific trust thus impressed upon the funds, the holders of the draft were entitled to preferential payment of the drafts. A further aspect of the documentary credit, the right of or derived from the beneficiary-seller, is thus knit—in the event of issuer's insolvency—into the underlying mercantile purpose, so that (a) the goods are moved and (b) the buyer-customer is protected from having to pay twice. The court did not rule on what the result would have been had the customer followed its first suggested procedure.

In the *Shawmut* case, the doctrine was further developed in accord with the underlying function of the institution. The action again grew out of a documentary credit. It was brought, after non-payment, by a holder in due course of the accepted draft against the beneficiary. The beneficiary impleaded the insolvent issuing bank. Simultaneous motions were made for summary judgment by the plaintiff against the beneficiary, and by the beneficiary against the issuer. Both motions were granted and the granting of these motions was affirmed on appeal. The court stated that the decision of the case "depends upon the nature and legal consequences" of the transaction between the customer who was not a party to the action and the issuing bank. In this case, the buyer-customer had received the documents and hence the goods on trust receipt from the issuing bank after that bank's acceptance of the draft. The customer had resold the goods and duly remitted the proceeds to the bank to be applied against the particular outstanding acceptance. The bank on receiving the payment credited its "prepaid acceptances account" and issued a notice to the

customer stating that their account had been charged for "acceptance due re letter of credit #8853." The only question before the court was whether such a general crediting by the bank constituted such a holding of funds for the express purpose of paying the draft at its maturity as warranted the recognition of a preference. It was held that it did. In this connection the court thought that the bank had "so set aside and appropriated the funds by putting them as a separate and unmistakably identified item of credit in its prepaid acceptances account that it was clear that there had been such an intention on the part of the bank and the customer." This preference accorded the holder of the acceptance is a mere resultant of the protection which has to be accorded the buyer-customer in furtherance of the mercantile transaction. The *Greenough* case begins, for instance, with ruling the buyer-customer not to have been discharged from his duty to pay the price by virtue of having provided his seller with the documentary credit. In the absence of contrary agreement, such a credit rates as "conditional," not as "absolute" payment. This ruling on the sales contract controls the whole situation from then on in. Thus no one of the cases rests on anything other than the legal relations existing between the applicant for the credit (the customer) and first, his seller, and second the issuing bank. It is the purpose for which the documentary credit was issued, for which the documentary draft was drawn, for which the documents were surrendered on trust receipt to the buyer-customer—it is this mercantile purpose of movement and resale of the underlying goods which is the only thing which justifies a pseudo-trust and consequent preference in documents, goods and proceeds in favor—once the bank is insolvent—of the holder of the draft. It is that same purpose which limits any such preference.⁵⁷ But the preference itself is precisely the kind of right of the beneficiary which depends upon "the legal relations existing between the applicant for the credit and his bank" and the "Uniform Customs" general statement, if the document should ever be read as displacing the existent rules of law, would negate the useful theory laboriously but successfully worked out in the New York line of insolvency cases.

Nor is this danger of negation of the theory of insolvency an empty one. The same facts, viewed in a different way and viewed without consideration of the relations existing between the customer and the bank, can be seen as a simple problem of preference or priority of any holder of any accepted draft. Under such an approach it seems reasonably clear that the results to be reached by a court would not be those of New York, but those in fact reached in Louisiana in the course of a bank insolvency in that jurisdiction.

Despite an early start in the same direction as the New York cases by its decision in *In re Canal Bank and Trust Co.'s Liquidation, Intervention of F. D. Wilcox Co.*,⁵⁸ the Louisiana court in subsequent cases departed from the New

⁵⁷ The ultimate test of this principle would be the case of the explicitly prepaid (cash collateral) sight credit, with insolvency before presentment. Section 5-117 of the Code takes this necessary next step.

⁵⁸ 178 La. 575, 152 So. 297 (1933).

York results. The *Wilcox* case was one which on its facts was substantially identical with the *Seltzer* case and, as in the *Seltzer* case, the Louisiana Supreme Court took the position that consideration for the issuance of the letter of credit had failed because of the issuing bank's inability to pay the accepted draft and that therefore the customer was entitled to pay drafts in the hands of the holders without any subsequent duty to also pay the issuing bank. In the case of *In re Interstate Trust and Banking Co.*,⁵⁹ the Supreme Court of Louisiana four years later had to pass on a situation substantially the same as that involved in the *Shawmut* case. In the situation before the Louisiana court, the buyer-customer, after resale of the goods released to him on trust receipt, had prepaid the accepted draft for their price by sending his check together with a letter setting forth that the check was for the specific purpose of retiring the drafts drawn by the beneficiary of the credit. In figuring the amount of the sum required he deducted a two dollar rebate for paying before the acceptance fell due. A claim for priority was made both by the customer and by the holder of the draft. The court rejected both claims to priority on the ground that the customer's prepayment was nothing more than payment of the obligation incurred in his letter of application and resulting more particularly from the sale of goods which had been released to him on trust receipt. So far as the beneficiary-holder was concerned, the court held that the letter accompanying the draft did not create a fund devoted to any specific purpose or trust relationship since the transaction included a discount or rebate for prepayment which could only be understood as indicating an intention that the bank should have the right to use the funds generally, any alternative theory as to prepayment with rebate was viewed as inconsistent with the bank's use of the money involved.

It will be noted that every argument made by the Louisiana court in favor of its position against preference was equally available to the New York court in the *Shawmut* case. But again the matter turned on what the court saw as the "legal relationship between the applicant for the credit and his bank." In the *Shawmut* case the customer had also received the goods on a trust receipt containing a commitment by him to pay over to the issuing bank the specific proceeds of the sale of those goods to the bank. He had therefore paid over his proceeds as had the customer in the Louisiana case for the purpose of discharging his liability under the trust-receipt agreement as well as prepaying the acceptance.⁶⁰ The amount which he had turned over also contained a rebate or discount for prepayment and was in fact noted on the books of the insolvent bank as an item in its prepaid acceptance account. In New York, the bank also had had the general use of anything in the transaction which could be equated to "money."

One of the interesting results of the *Interstate* case is that after it two further

⁵⁹ 188 La. 211, 176 So. 1 (1937).

⁶⁰ In *Shawmut Corp. v. Bobrick Sales Corp.*, 260 N.Y. 362, 184 N.E. 68 (1933) the customer seems to have put the proceeds into his own account and then sent an immediate instruction for debit in prepayment of the draft; and the debit was made less discount.

cases arose, one in the Louisiana state court,⁶¹ and the other in the local federal court,⁶² which involved an action by the beneficiary-seller directly against the customer-buyer who had already paid the insolvent bank. One, indeed, involved the same customer and beneficiary involved in the *Interstate* case. In both cases the court refused to make the customer pay a second time.

Either line of cases thus protects the buyer-customer against double payment if the issuing bank has happened to accept the documentary draft before going insolvent. But only the New York principle will achieve this result and also keep the goods moving in their arranged commercial course.

The net result of the Louisiana cases making payment to an insolvent bank by its customer the equivalent of payment to the beneficiary is to make the letter-of-credit transaction in any jurisdiction adopting the Louisiana rule a trap for the unwary seller of goods. In the New York sequence of cases, of course, the beneficiary of the credit could recover against the customer on the basis of his sales contract,⁶³ and the court explicitly stated in the *Greenough* case that this consideration of threatened dual payment by the customer was one of the major factors which led to its creation of the preference by impressing the funds offered by the customer to the issuing bank with a trust for payment of each relevant draft.

I urge that this divergence of result in New York and Louisiana represents a fundamental difference in perception of the sales and letter-of-credit transaction and of its meaning for commerce, financing and law. The issue of whether the provision of a documentary letter of credit for the seller is to be viewed as "absolute" payment by the buyer, discharging him from further obligation, is one which early agitated the courts, as did its somewhat similar counterpart, the furnishing of a check.⁶⁴

In the first case after the *Interstate* case (the one decided by the Louisiana Supreme Court),⁶⁵ much was made by the court of the fact that the beneficiary had selected the issuing bank and thereby assumed the risk of its insolvency; this served as the basic reason for the discharge of the buyer's obligation to pay under the sales contract. In the federal case,⁶⁶ on the other hand, this line of demarcation was treated as essentially non-significant. Despite the federal court it is appealing to make the issue of ultimate responsibility for insolvency

⁶¹ *Irmaos v. Hickerson*, 193 La. 495, 190 So. 657 (1939).

⁶² *Ornstein v. Hickerson*, 40 F. Supp. 305 (E.D. La., 1941).

⁶³ *Bassett v. Leslie*, 123 N.Y. 396, 25 N.E. 386 (1890); *Leslie v. Bassett*, 129 N.Y. 523, 29 N.E. 834 (1892).

⁶⁴ See *Hamilton v. R. S. Dickson & Co.*, 85 F. 2d 107 (C.A. 2d, 1936); *Hall v. Stevens*, 116 N.Y. 201, 22 N.E. 374 (1889). See Steffen, *Cases on Commercial and Investment Paper* 127 et seq. (1939).

⁶⁵ *Irmaos v. Hickerson*, 193 La. 495, 190 So. 657 (1939).

⁶⁶ *Ornstein v. Hickerson*, 40 F. Supp. 305 (E.D. La., 1941).

turn on which party chose the issuing bank.⁶⁷ At one time the Code in the Sales Article (Section 2-325) did draw just such a distinction. It was ultimately removed at the instance of merchants because they stated that designation of the issuer was too often a joint venture and that the problem of proof engendered by the proposed rule would be difficult and wasteful.⁶⁸

But when it comes to fixing on a single rule, the purposes of using a documentary letter of credit argue with great cogency the merely conditional nature of its use as a payment instrument, if it be treated as such an instrument at all. Security of payment is the one clear and dominant purpose; all else—translation of currency, convenience of place of payment, reasonable assurance that shipment has been made, facilitation of financing during transportation and during any trust receipt period—all such matters are not essences, but incidents. The central question of whether the documentary letter of credit is a mercantile specialty is of course one which ought to be decided affirmatively: security of payment requires that answer. But one of the major incidents of treating the credit as such a specialty is recognition that the relationship between the issuing bank and its customer is not a wholly independent one of creditor-debtor and that so far as payment of the beneficiary is concerned, the relation more nearly approaches that of payment agency with the principal (the customer) typically and almost necessarily earmarking particular funds for the purpose of meeting particular drafts. The fact that normally the issuer is also doing general financing of the customer should not obscure this fundamental characteristic of the transaction, reflected as it is not only in the thinking of each party but in the specific communications and the specific accounting entries of the customer and bank. A principal's funds in the hands of an insolvent agent are not, generally speaking, part of the agent's assets. So, too, funds of a customer earmarked for payment of particular letters of credit should not be viewed as part of the general assets of an insolvent issuer. The fact that such funds are not physically segregated by any bank merely reflects the nature of bank use of cash in a credit economy such as ours. Finally, foreign sellers need the security of knowing that drafts drawn under a letter of credit, a sales requirement which is entered into in major part to afford just such security, will be honored by either the bank or the customer. Customers need not only freedom from double payment but free movement of the goods and maintenance of relations with their sellers undisturbed by bitterness and loss when an American bank falls down on the basic obligation of international commerce. And the consuming public needs the rule which moves the goods most quickly, easily and cheaply. In a word, the Louisiana result of leaving the beneficiary

⁶⁷ This quality of how much trusting and by whom underlies some of the priority provisions of the Bankruptcy Act. Consult, e.g., Section 60e.

⁶⁸ This aspect is borne out by the federal case, *Ornstein v. Hickerson*, 40 F. Supp. 305 (E.D. La., 1941). I suspect the Louisiana Supreme Court case might well have had as ambiguous a record had counsel known the rule in advance.

with less security is undesirable for any nation seeking to promote its foreign trade. The only safe and commercially desirable solution is adoption of a provision such as Section 5-117 of the Code.⁶⁹

In the light of the conflict in the insolvency cases it is difficult to see how the New York Law Revision Commission can argue that the fundamental law governing letters of credit is either uniform or well-settled in the United States.

Establishment of Credits

The problem of insolvency is not the only area in which the "Uniform Customs" seem unintentionally headed for trouble. Another potential source of difficulty appears to lie in the area of the establishment and meaning of credits. Let us consider first the area of revocable credits. Articles 3 and 4 of the "Uniform Customs" make the following provisions:

All credits, unless clearly stipulated as irrevocable, are considered revocable even though an expiry date is specified.

Revocable credits are not legally binding undertakings between banks and beneficiaries. Such credits may be modified or cancelled at any moment without notice to the beneficiary. When a credit of this nature has been transmitted to a branch or to another bank, its modification or cancellation can take effect only upon receipt of notice thereof by such branch or other bank, prior to payment or negotiation, or the acceptance of drawings thereunder by such branch or other bank.

This language represents two changes over the language which had existed in the "Uniform Customs" adopted by the Seventh Congress of the International Chamber of Commerce and which had been deemed as operative until the effective date of the document adopted by the Thirteenth Congress of the International Chamber of Commerce.⁷⁰ The first change appears in the sentence dealing with the modification or cancellation of these credits and notice to the beneficiary. The old language read, "Such credits may be modified or cancelled at any moment without the bank being obliged to notify the beneficiary." The second change runs in terms of the addition in the new "Uniform Customs" of the language "prior to payment or negotiation, or the acceptance of drawings thereunder." There has also been a change made in that the old customs talked about transmission to a "correspondent or to a branch" whereas the new customs talk about transmission "to a branch or to another bank." I cannot determine what the reason for most of the changes in the language is. I assume that they must have some purpose. The effective time for cancellation as being that prior to payment or negotiation or the acceptance of drawings seems reasonably clear, but as for the other changes no good reason suggests itself.

The relevant sections of the Code are Section 5-105 and 5-106(2). Section

⁶⁹ Criticism at the Public Hearings was on the emotionally charged issue of "preference" and never faced the mercantile function of the letter of credit. N.Y. Law Revision Comm'n Study of Uniform Commercial Code, Leg. Doc. No. 65 (D) 53 (1954).

⁷⁰ The effective date of adherence of American banks was January 1, 1952.

5-105 reads "A credit is revocable unless it clearly stipulates that it is irrevocable; a credit so stipulating is an irrevocable credit." Section 5-106(2) reads as follows:

Unless otherwise agreed . . . (c) Revocable credits may be modified or cancelled at any moment without notice to the customer or the beneficiary. Any bank or branch authorized to honor or negotiate on behalf of the issuer is entitled to reimbursement for any draft duly honored or negotiated before receipt of notice of modification or cancellation.

The New York Law Revision Commission has raised some doubts as to the wisdom of the policy embodied in the presumption of revocability which appears in both the "Uniform Customs" and the Code.⁷¹ In my opinion the New York Law Revision Commission could not be sounder in its doubts. Quite apart from the fact that almost all banks report that they seldom use revocable credits, bank understanding of the right to cancel or modify under a revocable credit is not uniform in the United States.⁷² In addition the provision in the "Uniform Customs" that credits are presumed revocable "even though an expiry date is specified" makes for mercantile nonsense. Ward and Harfield suggest that whenever the revocable credit as it is found in the "Uniform Customs" is really intended, what the parties are talking about is an authority to pay or purchase and that to make sense that is the form which should be used.⁷³

It may be that what was intended by Article 3 of the "Uniform Customs" was to state a guide for use between banks in coding instructions to each other. If this is the case nobody can justly quarrel with the statement any more than anybody could quarrel with any other code word sought to be used by banks in communications between themselves. If Article 3 of the "Uniform Customs," however, is intended to be addressed to merchant beneficiaries most of whom have never heard of it, I am prepared to prophesy that the courts will perceive it as constituting a trap and will never enforce it. Nor should they enforce it. For merchants, it will be remembered, a provision in a sales contract calling for a letter of "credit" or a banker's "credit" means an *irrevocable* letter of credit.⁷⁴ This mercantile understanding is embodied in Section 2-325(3) of the Code, and is supported by the testimony of mercantile experts at the public hearings before the Law Revision Commission.⁷⁵

⁷¹ N.Y. Report of the Law Revision Commission to the Legislature, Leg. Doc. No. 65 (A) 62 (1956) (mimeo.).

⁷² One letter enclosing the bank's forms, for example, stated: "May we say that a confirmed Credit is always an Irrevocable Credit, and that we do not at any time confirm a Revocable Credit, as by the very nature of the term 'Revocable' a Credit can be cancelled upon notice to the beneficiary; whereas, a confirmed Credit cannot be." (Emphasis supplied.)

⁷³ Ward and Harfield 163.

⁷⁴ An examination of the standard sales contracts of 26 trade associations dealing in exports or imports indicates that some specify "irrevocable"; some say merely "letter of credit" and about half are completely silent. See Section 2-325 of the Code.

⁷⁵ N.Y. Law Revision Comm'n Study of Uniform Commercial Code, Leg. Doc. No. 65 (J) 116-17 (1954).

The technical difficulty with both the Customs and the Code provision is illustrated by the following hypothetical situation.⁷⁶ A bank issues a piece of paper to the beneficiary. *Nowhere is it stated that it is a revocable letter of credit.*⁷⁷ Having received this piece of paper which is conspicuously labelled "Letter of Credit," the merchant beneficiary notes its title. His sales contract, it will be remembered, had merely called for a "letter of credit" without specification as to revocability or irrevocability. In addition, it will be recalled, he does not know the content of the so-called "Uniform Customs." He does know what those words mean to merchants. (So also do bankers know this.) He notes also that the paper correctly lists the documents to be forwarded. He finally notes that the dates for shipment and presentment of drafts (expiry date) are correct. As a result of his receipt and examination of this piece of paper, he contracts for shipping space; he manufactures, or buys or segregates the goods and packages them; he sends them to seaboard and delivers them to the carrier; loads them on board the vessel; obtains the necessary insurance and other papers; and with a sigh of relief, he presents the draft and documents to either the bank which advised him of the "credit" (the bank to which the credit had been transmitted) or to his own bank for discount. Which he finally does depends in part on whether or not the credit contains a general engagement to honor drafts drawn on it, in which case, of course, his own bank is a person to whom such an engagement has been made; or whether the credit is limited to a particular bank ("domiciled" with it)—that is to say, to the bank of advise or transmission. Most credits are of the first type.⁷⁸ In other words, the shipper, with material outlay, duly performs each several condition on his part to be performed to entitle him to payment of the draft accompanying the documents.

Let us now assume that he has made presentment to the advising bank. The presentment, let us say, takes place at noon, and the bank quite properly and in accordance with its usual practice takes the papers for examination to see whether or not they comply with the credit. At 2:00 P.M. of the same day the advising bank receives cable notification that the credit has been cancelled. Under the provisions of Articles 3 and 4 of the "Uniform Customs," it would have no alternative but to refuse to honor the draft.

If the beneficiary insists upon payment he may then forward the documents for presentment to the issuer itself. There, too, the issuer under the express terms of Articles 3 and 4, and even though no prior notice of cancellation of any kind had been sent to anybody, would be in a position to refuse payment at will. In the situation in which the beneficiary's own bank has discounted the

⁷⁶ The hypothetical case is actually not so hypothetical, compare *First Wisconsin National Bank v. Forsythe Leather Co.*, 189 Wis. 9, 206 N.W. 843 (1926). See also for a holding of irrevocability in absence of stipulation, *Foglino & Co. v. Webster*, 217 App. Div. 282, 216 N.Y. Supp. 225 (1st Dep't, 1926), modified on other grounds, 224 N.Y. 516, 155 N.E. 878 (1926).

⁷⁷ This was true of 3 of the 5 banks which reported a revocable form.

⁷⁸ 32 of the forms have negotiation clauses.

paper and sent it forward to the issuer, under the provisions of Articles 3 and 4 of the "Uniform Customs" the issuer might nonetheless refuse payment on presentment because the seller's bank is not a bank to which the credit has been transmitted to be advised and therefore is not a bank to be protected by the requirement that notice be received by it prior to effective cancellation or modification, and this even though the credit be a negotiation credit. If the beneficiary is still in good financial condition, the item would now be charged back to his account. If he is not, the discounting bank would have to bear the loss. The important thing, however, from the point of view of the mercantile interest to be served—and indeed from the banking interest of a discounting bank—is that by the time the beneficiary learns of the projected cancellation or modification, the goods which underlie the transaction are dancing merrily across the waves and there is no real prospect of payment.⁷⁹

I do not believe that the courts will allow this result, for there are at least three technical roads to avoid it. The simplest road is to refuse to incorporate the "Uniform Customs" into the letter of credit. The New York Court of Appeals has shown the way to that result in three fairly recent cases involving incorporation by reference of standard provisions in sales forms which are much more likely to be known to contracting merchants.

All three cases involved an attempt to apply an arbitration provision included in the standard rules which the drafters of the forms involved had attempted to incorporate by reference. The three clauses were:

Sales are governed by raw silk rules adopted by the Silk Association of America.⁸⁰

This salesnote is subject to the provisions of the Standard Cotton Textile Salesnote, which, by this reference, is incorporated as a part of this agreement and together herewith constitutes the entire contract between buyer and seller.⁸¹

This contract is also subject to the Cotton Yarn Rules of 1938 as amended.⁸²

Only the second clause was held to be an effective enough incorporation to permit operation of the Arbitration Clause.⁸³ The other clauses were not deemed to be sufficient to put the other party to the sales transaction on notice of the fact of arbitration as the exclusive remedy under the contract. In other words what the court was suggesting was that standard rules promulgated by trade

⁷⁹ To say that the beneficiary has rights against the buyer-customer is frequently to say that he has illusory rights. Cancellation of a credit takes place because either something is wrong with the customer's financial standing, or the market price on the goods has so dropped that the customer is seeking an unjust way out of the situation. In this respect, the Code provisions are even worse than Articles 3 and 4 because they explicitly permit the bank to cancel or modify the credit without notice to its own customer.

⁸⁰ *Matter of General Silk Importing Co.*, 234 N.Y. 513, 138 N.E. 2d 427 (1922).

⁸¹ *Matter of Level Export Corp.*, 305 N.Y. 82, 111 N.E. 2d 218 (1953).

⁸² *Riverdale Fabrics Corp. v. Tillinghast-Stiles Co.*, 306 N.Y. 288, 118 N.E. 2d 104 (1954).

⁸³ It cannot be argued that this result is explicable by an antagonism to arbitration, since the New York Courts have always been very friendly to arbitration. See *Berkovitz v. Arbib & Houlberg*, 230 N.Y. 261, 130 N.E. 288 (1921).

associations could be incorporated by reference but only to the extent that they contained no matters which would come as a surprise to the person who had not prepared the form on which the incorporation appears. Since it obviously would come as a surprise to a merchant who had performed under the letter to discover he was not entitled to payment simply because a letter which conspicuously contained the solid word "credit" did not also contain the black-magic word "irrevocable," the rationale of the New York cases would be directly applicable to the "Uniform Customs" attempted incorporation of the revocability provisions.⁸⁴

The second technical road to avoid mercantile upset is to construe the revocable credit as an offer by the issuing bank and then apply to it the well-established, sensible rule that it cannot be revoked after acceptance. The existence of acceptance is clear, since even under the most ancient of contract doctrine this offer cannot be viewed as other than an offer looking to acceptance by conduct. The possible contra argument that presentment to the issuer is the last phase of acceptance and that until it also takes place revocation may occur is contrary to the better case law and the strong trend thereof as stated in Section 45 of the Restatement of Contracts.

The third technical road is simply to so construe the language of either the credit or the "Customs" as to prevent the injustice.⁸⁵ It can, for example, be pointed out that the words "unless clearly stipulated as irrevocable" cannot possibly require the use of the single word "irrevocable," so that any language which reasonably conveys the clear idea "irrevocable" must be operative; and that both the "Customs"—purely a bankers' document—and any letter of credit which is issued referring to them must be strictly construed against the issuing bank in favor of any mercantile beneficiary.⁸⁶

The Code provision is not in all respects as bad as the provisions appearing in the "Uniform Customs" for under the Code it can be argued that an "agreement otherwise" has taken place as soon as the beneficiary has performed the conditions of the credit and there is at least no nonsense about expiry dates. But the basic proposition of the New York Law Revision Commission that these provisions of the Code are doubtful in principle is, in my opinion, fully justified. If bankers really feel it vital in the interest of shorthand to retain these provisions in the customs they can and should be limited to communications between banks, and as so limited, can properly be a part even of the Code.⁸⁷ Unless it is so limited, no presumption whatsoever should be stated in the Code.

⁸⁴ See also Rest., Contracts § 247.

⁸⁵ This practice, which can and has led to much subsequent confusion in sales cases, is always available to the courts. Consult e.g., *Hardy v. General Motors Acceptance Corp.*, 38 Ga. App. 463, 144 S.E. 327 (1928); and comment to Section 2-302 of the Code.

⁸⁶ *Consolidated Sales Co. v. Bank of Hampton Roads*, 193 Va. 307, 68 S.E. 2d 652 (1952); *Powerine Co. v. Russel's Inc.*, 103 Utah 441, 135 P. 2d 906 (1943); *Moss v. Old Colony Trust Co.*, 246 Mass. 139, 140 N.E. 803 (1923).

⁸⁷ The Code should either delete Section 5-105 or limit it explicitly to communications between banks.

It should be noted that despite Articles 3 and 4 the definition of irrevocable credits which appears in Article 5 of the "Uniform Customs" does not require the use of the word "irrevocable." All that is apparently required is that there be a definite undertaking by an issuing bank to the beneficiary or to the beneficiary and bona fide holders of drafts drawn under the credit that the provisions for payment, acceptance or negotiation contained in the credit will be duly fulfilled provided the documents comply with the terms and conditions of the credit. The Code definition of credit, on the contrary, does provide in Section 5-103(1)(a) that the irrevocable credit be a signed writing "clearly stipulating that it is irrevocable by which a bank engages, [etc.]" The unsoundness of the "Uniform Customs" provisions on revocable credits is therefore to a considerable degree ameliorated by the definition of irrevocable credits found in that document and which easily permit a court to find irrevocability in our hypothetical case. The greater accuracy of the Code drafting does not permit of such easy cure. To be reasonable and workable Section 5-103(1)(a) should delete the phrase as to irrevocability.

It will be noted that in connection with the revocable credit, the "Uniform Customs" are so drawn as to seek to make even the existence of an expiry date immaterial. This is extraordinary in view of the importance with which the presence or absence of such a date in an irrevocable credit is treated. The relevant articles are Article 8 and Article 38. Article 8 provides:

In the event of the period of validity of a credit not being stipulated in an order to issue or confirm an irrevocable credit, the bank *may* advise the beneficiary of the credit for information only, and this implies no responsibility on the part of the bank doing so. The credit will only be issued or confirmed later when supplementary details on the duration of validity have been received [*italics added*].

Article 38 provides:

All irrevocable credits *must* stipulate an expiry date for payment, acceptance or negotiation notwithstanding the indication of a date of shipment [*italics added*].⁸⁸

Indication of a date of shipment has a great deal to do with the expiry date of an irrevocable credit⁸⁹ as, indeed, is recognized by the "Uniform Customs"

⁸⁸ Curiously enough, the revocable credit, which under Articles 3 and 4 is a much less worthy piece of paper, has the following said about its date of expiry in Article 41: "The validity of a revocable credit, if no date is specified, will be considered to have expired six months from the date of the notification sent to the beneficiary by the bank with which the credit is available." This has been criticized by the British. Rice and Thorne, *The Uniform Customs and Practices for Commercial Documentary Credits*, 56 *Canadian Banker* 53, 55 (1949).

⁸⁹ *Lamborn v. Nat'l Park Bank of N.Y.*, 212 App. Div. 25, 208 N.Y. Supp. 428 (1st Dep't, 1925), *aff'd* 240 N.Y. 520, 148 N.E. 654 (1925). Drafts and documents cannot be presented till after shipment, for until then, the bills of lading are not available. Credits, therefore, should not expire until there has been time after shipment to send them forward for presentment. This time can run from a few days to a month or more. The National Institute of Oilseed Products, for example, provides in Rule 55 of its Trading Rules that letters of credit must have expiry dates "at least fifteen (15) calendar days beyond the latest contract shipping date when usual directly in favor of an overseas shipper . . . and at least thirty (30) calendar days beyond the latest estimated time that good may arrive at Port of Discharge when credit is issued in favor of United States Seller. . . ." For merchants, shipment is the vital date.

themselves when in Article 45 they provide, "Any extension of the period of shipment shall extend for an equal period the time fixed for presentation or negotiation of documents or drafts. . . ." But quite apart from that, a certain inconsistency appears to exist between Articles 8 and 38.

If Article 8 means only that a bank which is going to act as an advising or confirming bank need not do so until it has received instructions as to the exact expiry date of the credit, and that if it wishes to, it may nevertheless advise the beneficiary that such a credit is being arranged but that it has not yet been issued, then there can be no real quarrel with its substance, and the only question is why it needs to be said. If, on the other hand, the clause is to be read as meaning that if a bank in *advising* a beneficiary of the issuing of the credit puts on top of the advising letter some such notation as "For Information Only" that then the credit has not been issued so far as the beneficiary is concerned and may as a result be revoked or cancelled without his consent despite the fact that the credit fits the definition of irrevocable credit in Article 5, then the clause would become another effort at a potential trap for beneficiaries. It would hardly be possible to argue that this second interpretation was the intended interpretation were it not for the presence of Article 38. But Article 38, unlike Article 8, is not permissive in character. It uses the word "must" rather than the word "may." It, therefore, seems to mean that unless this requirement is fulfilled there is to be no irrevocable letter of credit. I suppose that under this article, the result would be that there was a revocable credit. But this, of course, is again inconsistent with the definition of irrevocable credit which appears in Article 5 and which makes no mention of an expiry date, and Article 5 also makes it clear that an irrevocable credit can neither be modified nor cancelled without the agreement of all concerned including, of course, the beneficiary.

Quite apart from the vexing problem of the meaning of these Articles, I suggest that what has happened in the "Uniform Customs" is that in articles such as these the banks have set forth rules of procedure for their own guidance in the form of check notes or remarks to each other about things as to which they ought to be careful.⁹⁰ In other words, I suggest that, for example, the "must" language of Article 38 is merely a precatory statement to banks to call to their attention the fact that an expiry date is an important date in an irrevocable credit and should be asked for if not supplied in the original instructions to issue or confirm, or is at most a warning that to advise an irrevocable credit before an expiry date has been received is to act on a defective authorization. Such a date is of real importance since its existence not only warns the beneficiary of the end period of the credit but also would avoid all questions which otherwise arise under the law as to what is a "reasonable time" to negotiate or

⁹⁰ Consult also remarks in Article 5 about issuing banks sending forward originals of letters of credit which advising banks have been instructed to open by cable or telegram.

to present a draft drawn under a letter of credit.⁹¹ I suggest likewise that the language of Article 8 merely says to the advising bank: In the event the issuing bank fouls itself up by failing to send you the appropriate dates, be sure and write back for the dates and do not merely issue the letter of credit because if you do, you may be in trouble. If construed, as I think they properly must be, as merely precatory remarks from one bank to another, or lines of guidance in the internal conduct of business between correspondents, nobody can of course object to the remarks as made, although if I were a bank, I should like a little more clarity.⁹² If, however, such Articles should be urged as binding upon a beneficiary or for that matter upon a customer, in the sense that until the things they have mentioned have taken place, the credit is not so established that it can be modified or cancelled only with the consent of both the customer and the beneficiary, then I suggest that they are undesirable and that, as in the case of revocable credits, they should not be followed by any court in the United States.

The Code provisions in Section 5-106 are infinitely preferable and when amended to eliminate the presumption of revocability and the time during which cancellation or modification should be permitted, would go far towards settlement of a sound rule for the establishment of letters of credit. Beneficiaries who have acted in reliance should not be punished for errors and sloppy practices of issuing and advising banks. Nor should customers be without remedy for error, negligence or other fault of the banks involved, whether in the matter of establishment of the credit, or in general.

Allocation of Risks of Negligence or Other Fault

Both the "Uniform Customs" and the Code deal with the problem of allocating the risks of negligent or erroneous handling by banks of the letter-of-credit transaction. The parties among whom these risks may be allocated are the buyer-customer, the seller-beneficiary, the issuing bank, the advising bank, and any bank which may negotiate drafts for the seller. In addition to risks of negligent or erroneous handling by banks, there are the risks of error, negligence or other fault of third parties who touch the transaction at various points: the persons, such as telegraph or cable companies, who handle the messages concerning the credit; the carrier who issues the relevant bill of lading; the insurance company or broker who issues the relevant insurance policy or certificate; the weighmaster who issues weight certificates; the inspector who issues inspection certificates and the like. Risks affecting this type of third party, in the absence of very special circumstance, should, as against the bankers, be borne

⁹¹ See Uniform Negotiable Instruments Act §§ 136, 186; *Murfreesboro First Nat'l Bank v. Nashville First Nat'l Bank*, 127 Tenn. 205, 154 S.W. 965 (1913); *Miller v. Farmers' State Bank*, 165 Minn. 339, 206 N.W. 930 (1925).

⁹² The relationship between the issuing bank and the advising bank is probably one of principal and agent. As an advising bank, I would be interested in the scope of my fiduciary liability in the light of Articles 8 and 38 if I did advise a beneficiary that an irrevocable credit had been issued by my principal when it contained no expiry date.

by the customer or beneficiary, as should the risk of non-conformity of the goods. This is recognized by the Code⁹³ and by the "Uniform Customs."⁹⁴

The "Uniform Customs" as drawn seem to overreach themselves, however, on this point. Article 11 quite properly disclaims bank responsibility for the "genuineness" (its converse, "falsification") and legal effect of the documents or papers submitted by the beneficiary.⁹⁵ It then, however, proceeds also to disclaim responsibility for "the form," "correctness" and "sufficiency" of the documents or papers. If by "sufficiency" it means only "legal effect," the difficulty is only one of whether and why the same thing is being said in two different ways. But if the Article means by "sufficiency" as read with "correctness" and "form" the issue of whether the documents or papers are "regular in form" and *on their face* "sufficient and correct" under the terms of the credit, obviously the attempted disclaimer is wholly repugnant to the nature of a letter of credit and is inconsistent both with the duty recognized as resting on the bank by Article 9 which reads: "Banks must examine all documents and papers with care so as to ascertain that on their face they appear to be in order," and with the statement of conditions precedent to the bank's right to reimbursement from its customer which appears in Article 10:

Payment, negotiation or acceptance against documents in accordance with the terms and conditions of a credit by a bank authorized to do so binds the party giving the authorization to take up the documents and reimburse the bank making the payment, negotiation or acceptance.

Significantly enough, the overreaching portion of the language of disclaimer found in Article 11 does not appear in 30 of the forms used as customer applications. Where the individual form is more limited, the courts will probably treat the Article as having been displaced.⁹⁶ The overreaching is, therefore, of relatively small practical significance. The attitude expressed is, however, significant.⁹⁷

Dealing with bank negligence or error, the "Uniform Customs" again both are confusing and have a tendency to overreach. The relevant Articles are 6 and 14:

6. Irrevocable credits may be advised to the beneficiary through an advising bank without responsibility on the latter's part.

14. Banks are authorized to make provision for credits with other banks, for the account and at the risk of the applicants for the credits.

⁹³ Sections 5-107(3), 5-108(3), and 5-110.

⁹⁴ Articles 11, 12 and 13.

⁹⁵ I am assuming that the draft bearing the beneficiary's signature as drawer is not one of the "documents or papers" there included. Obviously the bank is responsible for forged drawer signatures.

⁹⁶ At least one bank, aware of this probability, has added to its customer application language indicating the "Uniform Customs" are to be read as increasing rather than limiting its rights and privileges.

⁹⁷ Compare the British attitude, *infra* text at notes 162, 165 and *supra* at note 29.

Banks utilizing the services of another bank assume no liability or responsibility (unless they themselves are at fault) should the instructions they transmit not be carried out exactly, even if they have themselves taken the initiative in the choice of their correspondent.

The applicants for the credit are responsible to the banks for all obligations imposed upon the latter by foreign laws and customs.

The net impact of these two articles can best be judged in a case in which the advising bank advised a credit incorrectly. Under a literal reading of the language of Article 6, the advising bank would have no responsibility for its own error. This cannot have been intended. If it were, it should be stricken as against public policy particularly since under Article 14 the issuing bank is to have no responsibility for the advising bank's error. I assume that despite the literal language of Article 6, all that was intended by it was to state the rather obvious proposition that merely, though correctly, advising a credit imposes no duty to honor it upon the advising bank.

Neither Article deals with the questions of whether or not under these circumstances of error a credit has been established or whether the terms of the credit are as advised or as instructed by the issuing bank. The obviously intelligent rule is that provided by the Code in Sections 5-108(1) and (2).⁹⁸ The credit is established and is enforceable according to its original tenor.⁹⁹

Another point of policy raised by Article 14 is the disclaimer of responsibility by the issuer for the acts of a correspondent even though it has itself selected the correspondent. The Code goes along with this disclaimer in Section 5-107(3). Basically what this means is that the burden of any litigation against the advising bank is assumed by the buyer-customer. That in turn has an unhappy by-product: it substitutes for the issuing bank in any negotiation looking toward adjustment, a distant stranger without standing, working relations, or expectation of future business. But with regard to any litigation itself, in view of the relatively low cost of letters of credit,¹⁰⁰ the result is at least arguably justifiable in all but one situation.¹⁰¹ That situation is where the correspondent bank which has committed the error is in reality a branch of the issuer, although legally it is a separate corporation.¹⁰² In such a case, the burden of litigation (with peculiar emphasis on the problems of settlement and review) seems to me to rest prop-

⁹⁸ "(1) Unless otherwise specified, a bank by advising that another bank has issued a credit assumes obligation for the accuracy of its own statement only. (2) Even though an advising bank incorrectly states the terms of the credit, its original terms control with respect to the issuer."

⁹⁹ Compare Uniform Negotiable Instruments Acts § 124.

¹⁰⁰ 1/4% or so of the amount of the credit.

¹⁰¹ In speaking of Article 14, a British banker has stated: "It is very doubtful whether a British bank would attempt to avoid responsibility for the failure of its foreign correspondent to carry out its instructions correctly, certainly not where the choice of correspondent was left to its discretion." *Documentary Credits*, 165 *The Banker's Magazine* 23, 24 (1948).

¹⁰² Obviously a branch which is not a separate corporation is an issuer.

erly on the issuer. My view in this matter is influenced by the advertisements which issuers having such foreign branches place in the national magazines and newspapers.¹⁰³ Such advertising sets a basis for dealings and seems to me to have a slightly fraudulent tinge unless backed by a willingness of the advertiser to assume responsibility¹⁰⁴ for the conduct of its "branch." The Code should be revised to provide accordingly.

Negotiation Credits

There is one troubling problem which is not dealt with in either the "Uniform Customs" or the Code, and which could easily be settled by adding a section to the Code along some such lines as are indicated in the footnote.¹⁰⁵ The problem arises because of three separate clauses which are found simultaneously in many credits, only one of which however has a counterpart in the "Uniform Customs." The clauses are as follows: (1) "We hereby agree with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same shall be duly honored on due presentation to the drawee." This is the "negotiation clause." (2) "Unless otherwise expressly stipulated, banks may pay, accept or negotiate for partial shipments, [even though the credit mentions the name of a vessel and when partial shipment is made by that vessel.]"¹⁰⁶ (3) "Bills of lading must be issued to our order" (meaning issuer's order).¹⁰⁷

¹⁰³ Consult, e.g., 34 Foreign Affairs no. 3 (April, 1956).

¹⁰⁴ The principles underlying *Carill v. Carbolic Smoke Ball Co.*, [1893] 1 Q.B. 256 and its ilk seem to be to be directly in point.

¹⁰⁵ "Notation Credit"; Exhaustion of Credit.

- (1) A credit which specifies that any person purchasing or paying drafts drawn under it must note the amount of the draft on the letter or advice of credit is a "notation credit."
- (2) Under a notation credit
 - (a) a person paying the beneficiary or purchasing a draft from him acquires a right to honor of the draft only if the appropriate notation is made and by transferring or forwarding for honor a draft under such a credit he engages with the issuer that such notation has been made; and
 - (b) unless the credit or a signed statement that appropriate notation has been made accompanies the draft the issuer may delay honor until evidence of notation has been procured which is satisfactory to him but his obligation and that of his customer continue for the time reasonably necessary to obtain such evidence; but
 - (c) a person purchasing in good faith is entitled to rely on the credit to the extent that the notations show an unused balance.
- (3) If the credit is not a notation credit
 - (a) the issuer may honor complying drafts presented to it in the order in which they are presented and is discharged pro tanto by honor of any such draft; but
 - (b) as between competing good faith purchasers of such drafts prior in time of purchase is prior in right even though the later purchased draft has been first honored.

¹⁰⁶ The bracketed language is from Article 36 of the "Uniform Customs" but does not appear independently in any of the individual bank forms. This is another instance of mercantile nonsense, for which there is not even a banking reason. See critical comment of British bankers in Rice and Thorne, *The Uniform Customs and Practice for Commercial Documentary Credits*, 56 *The Canadian Banker* 53, 57 (1949).

¹⁰⁷ Of 32 bank forms containing a negotiation clause, 9 use this form. The rest call for bills of lading to shipper's order blank endorsed or are silent.

Whenever there is a negotiation credit, there is potential danger of double or triple negotiation unless each negotiating bank has noted or endorsed on the letter on which it relies the amount of the draft it has discounted for the beneficiary or unless it has taken up the letter itself.¹⁰⁸ The first half of the problem might not exist were partial shipments not routinely permitted, but since they are, the question of who should bear the loss (presumably the wicked beneficiary has fled) as between the issuer and the various negotiating banks arises. To the extent that the "we engage" clause is followed by a requirement of notation,¹⁰⁹ the bank which fails to note is the one which is responsible for the subsequent difficulty and should therefore bear the loss. Non-notation on such a letter can be treated as founding an estoppel. On the other hand, an issuer who pays without documentary evidence that such notation has been made can also be argued to be negligent. The practical difficulty is that the beneficiary is entitled to possession of the letter till the credit is exhausted so that documentary evidence of notation would require another piece of paper known as a "certificate of endorsement." There has proved to be great difficulty in obtaining such a paper. Many issuers, therefore, instead of requiring certificates of endorsement took the position, and so stated on their letters, that forwarding for honor a draft and its documents constituted a representation and warranty of notation.¹¹⁰ Some New York banks, as Ward and Harfield report,¹¹¹ were fearful that negotiating banks would be loath to make such a warranty. Such issuing banks removed the requirement of notation entirely from the face of the credit. The theory of this was that each negotiating bank would then negotiate at the peril of subsequently discovering that the credit had already been exhausted by prior drafts. Why negotiating banks would prefer to take the risk of non-payment in this form rather than be fully protected by making an appropriate notation is hard to understand, unless the theory is that unknown risks do not hinder action—though they would undermine the solidity of the letter of credit as an institution. But there is also real and reasonable doubt that exhaustion, especially of a negotiation credit, would operate as a defense to a claim based on reliance on the letter of credit itself.¹¹² The bank's own engagement to honor in a formal document expressly inviting reliance by "bona fide holders" is not on a par with its deposit relationship where "insufficient funds" is a well recognized reason for non-payment or with the limited and special

¹⁰⁸ *Bank of Seneca v. First Nat'l Bank*, 105 Mo. App. 722, 78 S.W. 1092 (1904); Ward and Harfield 172.

¹⁰⁹ Typical clauses are: "The amount of each draft drawn under this credit must be endorsed hereon." "The amount of each draft negotiated, with the date of negotiation, must be endorsed hereon." "The amount of any draft drawn under this credit must be endorsed on the reverse hereof."

¹¹⁰ 10 of our forms take this position.

¹¹¹ Ward and Harfield 172.

¹¹² See *Bank of Seneca v. First Nat'l Bank*, 105 Mo. App. 722, 78 S.W. 1092 (1904), and more particularly, *American Bank and Trust Co. v. Banco Nacional de Nicaragua*, 231 Ala. 614, 166 So. 8 (1936), and the same case after trial in 238 Ala. 128, 189 So. 191 (1939).

agency of the early law of guaranty. The better solution seems clearly to be that of the warranty of notation and the situation is plainly one in which legislative action is needed to clarify results and unify practice.

The use in the forms of the requirement that the bills of lading be issued to issuing bank's order is repugnant to the very concept of a negotiation credit for such issue would make it impossible for any negotiating bank to acquire a security interest in the bill of lading as a person to whom a bill had been duly negotiated.¹¹³ Fortunately the rule of repugnancy¹¹⁴ is available to make bills issued to shipper's order, blank endorsed proper tender under a letter of credit containing both a negotiation clause and a bills to issuer's order clause.

Finally, as indicated in the discussion on transferability, the presence of the negotiation clause can be viewed as repugnant to the prohibition of transfer found in Article 49 of the "Uniform Customs." Again the situation seems one which requires legislative treatment to give letter-of-credit transactions that legal certainty and solidity which the business and banking community needs for maximally efficient operation.

Transfer and Assignability of Credit: Validity of Back-to-Back Credits

Both the "Uniform Customs" and the Code attempt to deal with the problems inherent in the beneficiary's attempt to use his irrevocable letter of credit as a means of financing himself. The beneficiary, it will be remembered, is the seller. As a seller he has the problem of obtaining the goods which are to be shipped to the customer (the buyer). He can only obtain them by growing them, manufacturing them or buying them from someone else. Any of these methods requires that he finance himself during the acquisition period.¹¹⁵ If he does not have sufficient capital of his own, this financing must come in the form of bank or finance company advance. Most financiers prefer secured financing.¹¹⁶ Speaking practically when the beneficiary obtains his irrevocable letter of credit, he

¹¹³ Uniform Bills of Lading Act § 40; Uniform Sales Act § 20. See use of this argument in *Pintel v. Mohamed & Bros.*, 107 Cal. App. 2d 558, 237 P. 2d 315 (1951) as an argument against the possibility of negotiation of the draft.

¹¹⁴ "In many cases cited and relied upon by the defendant in its brief, the point of contention was as to the time the title to the goods shipped under a c.i.f. contract passed from seller to buyer, and who should bear the loss arising from their destruction during transportation, due to an act of war or some peril not covered by the insurance. In some of the cases the provision calling for payment against shipping documents was written into the printed form, and the form also contained a printed clause excusing the buyer in case of loss during transportation. It was there held that the printed clause excusing the buyer in case of loss was inconsistent with the one written in; that it was inconsistent with the title passing on delivery of the goods to the carrier." *American Sugar Refining Co. v. Page & Shaw, Inc.*, 16 F. 2d 662, 665 (C.A. 1st, 1927). See also *Ellis v. Dodge Bros.*, 246 Fed. 764 (C.A. 5th, 1917). But see *Standard Casing Co. v. California Casing Co.*, 197 App. Div. 187, 188 N.Y.S. 358 (1st Dep't, 1921).

¹¹⁵ The nature of our exports precludes in the normal course of events any financing of the beneficiary by his own seller. Open account shipment is not common in the trades involved.

¹¹⁶ Every single one of the individual bank forms had some provision for security.

has obtained the engagement of a prime bank to pay or accept his drafts provided the documents accompanying them comply with the terms of the credit.¹¹⁷ The letter of credit, therefore, is an asset at least equal to, and typically of greater weight than, the normal business contract. It is liquidated; it is of prime quality; and it is formally and clearly evidenced. If the beneficiary has a credit which contains the standard negotiation clause, he has a promise or engagement which runs not only to himself but to all persons negotiating his drafts. As already indicated,¹¹⁸ a great many of the credits advised, issued or confirmed in the United States do contain such clauses. The question of to whom the promise is made may be of legal significance on the issue of assignability of the credit or its proceeds. The law of assignment which can be viewed as applicable to this situation is either the general law of contract which turns on the personal nature of the performance of the beneficiary or that particular phase of the law of contracts which deals with guaranties. Letters of credit have been viewed by some courts as guaranties,¹¹⁹ and when thus viewed the test of assignability of the credit turns on whether its form is "special" or "general."¹²⁰

Article 49 of the "Uniform Customs" provides, "A credit can be transferred only on the express authority of the opening bank and provided that it is expressly designated as "transferable" or "assignable." I suggest that this provision is repugnant to any credit containing a negotiation clause unless it be read as meaning what Section 5-115(1) of the Code provides: "The right to draw under a credit can be transferred or assigned only on the express authority of the issuer and provided that the credit is expressly designated as transferable or assignable." Read that way, the prohibition against transfer without express authorization of issuer and letter means only that the signature of the drawer of the drafts drawn under it must be that of the beneficiary. It does not mean

¹¹⁷ It is hard to urge that in a jurisdiction which has not adopted the Uniform Commercial Code, the beneficiary has this engagement as a matter of law. The requirement of consideration can be used to destroy its legal value. The importance of this aspect of the Code seems not to have been perceived either by the Code's critics or by the New York Law Revision Commission. Yet, Section 5-106(1) eliminating consideration as a legal requirement of irrevocability is the legal base on which true irrevocability rests. For the common-law difficulties with this problem, see Finkelstein, *Legal Aspects of Commercial Letters of Credit* 89-90, 290-93, 111-17, 250-52 (1930).

¹¹⁸ Consult note 107 *supra*.

¹¹⁹ See e.g., *City State Bank and Trust Co. v. United Paperboard Co.*, 146 S.W. 2d 832 (Tex. Civ. App., 1940); *Bernard & Co. v. United Hardware & Tool Corp.*, 251 App. Div. 539, 296 N.Y. Supp. 164 (1st Dep't, 1937); *Powerine Co. v. Russel's Inc.*, 103 Utah 441, 135 P. 2d 906 (1943); *John S. Barnes, Inc. v. Paducah Box and Basket Co.*, 147 Fla. 362, 2 So. 2d 861 (1941); *Merchant's Nat'l Bank v. Citizen's State Bank*, 93 Iowa 650, 61 N.W. 1065 (1895).

¹²⁰ For the guaranty situation, *Bernard & Co. v. United Hardware*, *ibid.*; *McAllister v. National Bank*, 40 N.M. 143, 56 P. 2d 485 (1937); *Chase Nat'l Bank v. Burg*, 32 F. Supp. 230 (D. Minn., 1940). For letters of credit, see *American Steel Co. v. Irving Nat'l Bank*, 266 Fed. 41 (C.A. 2d, 1920); *American Nat'l Bank & Trust Co. v. Banco Nacional de Nicaragua*, 231 Ala. 614, 166 So. 8 (1936).

that the drafts may not be assigned or negotiated by the beneficiary to another person prior to presentment to the issuer.¹²¹

Reading the prohibition of Article 49 in this manner, however, leads to the inevitable conclusion that the definition there contained of "a transferable or assignable credit" as "a credit in which the paying or negotiating bank is entitled to pay in whole or in part to a third party or parties on instructions given by the first beneficiary" is at best inaccurate and at worst highly confusing since that definition should have no application to the case of negotiated drafts drawn by the beneficiary payable to his own order and then endorsed to another, and yet the endorsement can be viewed as such "instructions." The definition rather should be limited to the case dealt with in Section 5-115(2) of the Code—the case of assignment of the proceeds of a credit.¹²²

Our case law is generally moving in the direction of free assignment of proceeds as a vital aid to secured financing generally.¹²³ In this movement the interest of the contract-debtor (in the case of letters of credit, the issuer; in the case of sales, the buyer) in not being bound to take care of payments to assignees is balanced against that of the seller (beneficiary) in having prime assets available as security. The net policy solution of the Code found in Section 9-318 and repeated in major outline in Section 5-115(2) seems the most practicable despite the New York Law Revision Commission's doubts as to its wisdom because without it, the more prime the standing of the account debtor, the more likely the prohibition against assignment.

The assignment of proceeds of a credit which appears to be envisaged by the definition in Article 49 of the "Uniform Customs," however, is not what the Article talks about in the rest of its provisions. Once authority for transfer has been obtained, Article 49 lays down the following rules for transfer, which are more generous than those in its predecessor Article,¹²⁴ but very different from what the British¹²⁵ think they ought to be:

[T]he credit can be transferred once only (that is to say that the third party or parties designated by the first beneficiary are not entitled to retransfer it) and on the terms and conditions specified in the original credit, with the exception of the amount of the credit, of any unit price stated therein, and of the time of validity or of shipping, any or all of which may be reduced or curtailed. In the event of any reduction in amount or unit price, a transferer may be permitted to substitute his own invoices for those of the transferee, for amounts or unit prices greater than those set forth in the transferee's invoices, but not in excess of the original sum stipulated in the credit, and upon such

¹²¹ Cf. *Second Nat'l Bank v. Columbia Trust Co.*, 288 Fed. 17 (C.A. 3d, 1923).

¹²² The basic argument for free assignability of such proceeds is so well made in McGowan, *Assignability of Documentary Credits*, 13 *Law & Contemp. Prob.* 666 (1948), that it needs no repetition here. The Code provision is a compromise one.

¹²³ 4 *Corbin on Contracts* § 872 (1951) and cases cited therein.

¹²⁴ Ward and Harfield 195.

¹²⁵ 175 *The Banker's Magazine* 481 et seq. (1953).

substitution of invoices, the transferer may draw under the credit for the difference between his invoices and the transferee's invoices.

Fractions of a transferable or assignable credit (not exceeding in the aggregate the amount of the entire credit) may be transferred separately provided partial shipments are not excluded, and the aggregate of such transfers will be considered as constituting only one transfer of the entire credit.

Authority to transfer a credit includes authority to transfer it to a beneficiary in another place whether in the same country or not, unless otherwise specified. During the validity of the credit as transferred, payment or negotiation may be made at the place to which the credit has been transferred.

Bank charges entailed by transfers are payable by the first beneficiary unless otherwise specified.

No transfer shall be binding upon the bank which is to act thereunder except to the extent and in the manner expressly consented to by such bank, and until such bank's charges for transfer are paid.

[In the United States, when credits are transferred to a beneficiary in another place whether in the same country or not, the credits may be changed from one requiring payment on or before a certain date to one requiring negotiation on or before that date, and during the validity of the credit as transferred, payment or negotiation may be made at the place to which the credit has been transferred.]

These rules seem to limit the Article despite their definition of "transferable" credits to the case which in the general law of contracts would tend to be described as "novation"¹²⁶ at its strictest and delegation of performance at best. This is not a frequent situation for it involves real substitution of sellers and obviously should be permitted only when authorized by the customer-buyer. But the rules are not geared to, nor should they be applied to, an assignment of the proceeds of a credit.

Typically, use of the letter of credit as an asset for financing will be by way of assignment of proceeds with or without a new letter issued by the assignee or on its behalf to the beneficiary's supplier.

The typicality of the assignment practice and its relation to old Article 49 was involved in *Kingdom of Sweden v. N.Y. Trust Co.*¹²⁷ The facts in this case are particularly enlightening because they indicate so clearly the extent to which the letter of credit is an instrument used not only as a payment device but as a means of further financing of the seller-beneficiary.

The war engendered a great demand for a chemical called toluene. Shortly after our entrance into the war, the Office of Production Management notified the warehouseman in whose tanks particular toluene was stored not to release it without specific authorization. This notice for the toluene involved in the case

¹²⁶ Rest., Contracts § 424 defines "novation" as "a contract that (a) discharges immediately a previously contractual duty or a duty to make compensation, and (b) creates a new contractual duty, and (c) includes as a party one who neither owed the previous duty nor was entitled to its performance."

¹²⁷ 197 Misc. 431, 96 N.Y.S. 2d 779 (S. Ct., 1949).

was received by the warehouseman on or about January 16, 1942. The first thing to be noticed about this toluene is that the warehouse receipts covering its storage in the tanks had been issued to the Manufacturer's Trust Company of New York and were held by them. It is obvious that at this point the goods were being financed by way of pledge of warehouse receipts, and that payment would have to be made in some way to the Manufacturer's Trust to get the receipts.

Prior to the issuance of this order of the Office of Production Management, however, the owner of the goods had already agreed to sell the toluene to a broker. The broker made an offer of this toluene to the Refiner's Export Company of Houston, Texas. This company in turn offered the toluene to the Swedish Marine Board which was the purchasing department of the Swedish government. The order was accepted by the Swedish government on January 19, 1942, but there was some question as to which agency of the government should act as the actual buyer. The final contract of purchase was signed between the Swedish Government Cargo Clearance Committee, a Swedish government agency charged with assembling and shipping cargoes from the United States to Sweden, and the Refiner's Export Company. This contract contained, of course, a clause providing for payment against letter of credit. The Refiner's Export Company in turn signed a contract with the broker in which the broker's payment was also to be against letter of credit. We have no information about the sales contract between the broker and the owner of the toluene. The Refiner's Export Company advised the New York Trust Company of its contract with the broker and of the necessity for the issuance of a letter of credit to the broker under that contract. It also informed the New York Trust Company that it was expecting a credit in its own favor from the Swedish bank. On January 21, 1942, the Swedish bank did cable the New York Trust Company ordering the issuance of an irrevocable confirmed credit in favor of Refiner's Export Company against tender of invoices, warehouse receipts issued to Manufacturer's Trust and endorsed in blank by them and inspection certificates. These documents were to be delivered to the Swedish Cargo Clearance Committee in New York after receipt by the New York Trust Company. The New York Trust Company immediately notified Refiner's Export Company by teletype of this cable and advised it that it had confirmed the Swedish bank's credit under its commercial credit #37173. The request of Refiner's Export Company that New York Trust Company re-establish on its confirmed credit, a credit to the broker, was met by a statement from the New York Trust Company that such a letter of credit should be requested of it by the Second National Bank of Houston, Texas, and that it would not be established on the request of Refiner's Export Company alone. On the next day, the Second National Bank of Houston requested that the New York Trust Company as its agent establish a letter of credit for account of Refiner's Export in favor of the broker for an amount of \$133,000.00 as opposed to the \$172,000.00 for which the original credit was

opened, payable against tender of the same documents as those required by the credit already issued by the New York Trust Company except for invoices and inspection certificates. It also requested that the New York Trust Company retain its own confirmed credit issued on behalf of the Swedish bank in favor of Refiner's Export Company as security for the Texas bank. This request for the issuance of a credit to the broker was approved by the New York Trust Company, and it thereupon issued its own credit to that broker, retaining its original credit as security for its principal, the Texas bank.

It is worth while to stop at this point to find out what the relations of the parties to each other were. The first thing to be noted is that the Texas bank in requesting the New York Trust Company to establish a letter of credit for the account of the broker from whom its own customer, Refiner's Export Company, was buying the goods, asked for the issuance of that letter by the New York Trust Company as its agent and simultaneously asked the New York Trust Company to retain the confirmed credit it had already issued to Refiner's Export as security. In other words, it seems reasonably clear that Refiner's Export, in order to get the Second National Bank of Houston to make its request to the New York Trust Company, had been forced to assign to the Second National Bank of Houston the letter of credit issued by the New York Trust Company as security for any liability Second National Bank might incur as a result of the issuance of the letter of credit to the broker. One would have thought on this state of facts that the true issuer of the second letter of credit was the Texas bank and that New York Trust Company was only an agent. The letter issued to the broker, however, was by New York Trust Company as issuer with Refiner's Export named as customer and the Texas bank unmentioned. So far as the letter of credit indicated, the only position the Second National Bank of Houston had was that of a person to whom the first credit had been assigned as security by the beneficiary thereof.¹²⁸ If the "Uniform Customs" were incorporated in the first letter of credit,¹²⁹ a construction of Article 49 as prohibiting assignment of proceeds for security would mean that the beneficiary had violated its terms, and that New York Trust Company, when it issued the second letter, had full knowledge of that violation by virtue of notice received from the assignee of the credit.

The beneficiary-broker of the second letter requested the New York Trust Company to allow presentment to be made to it at the offices of the Manufacturer's Trust Company. This was done and *payment under that letter was made*

¹²⁸ The arguments at the public hearings on whether a person in the position of the Texas bank would be a "customer" under Section 5-103(1)(g) should be resolved by amendment of the Code to indicate that the answer is "yes," so as to obviate the possibility of limiting such a bank's liability to reimburse the issuer which would result from treating the Texas bank merely as an assignee.

¹²⁹ A matter of considerable doubt, since the teletype confirmation to Refiner's Export Company contained no mention of them. The teletype notice presumably "established" the credit. See *Pan-American Bank & Trust v. Nat'l City Bank*, 6 F. 2d 762, 767 (C.A. 2d, 1925).

to *Manufacturer's Trust*. It is clear from this mode of payment that a special arrangement had been worked out between the original owner of toluene, the Manufacturer's Trust as pledgee of the warehouse receipts and the broker for payment of the Manufacturer's Trust lien by way of what in essence was an assignment by the broker to the original owner of the proceeds of the second letter and from him to the Manufacturer's Trust. If the second letter incorporated the "Uniform Customs" and they are read to preclude assignment of proceeds, this too was a violation of the credit.

At this point, New York Trust Company had the warehouse receipts called for by the first letter of credit but did not have the invoices, the drafts or the inspection certificate, which were the other documents called for. It nonetheless debited the account of the Bank of Sweden, which was its customer, on the first letter of credit for the full amount of that credit. Simultaneously *it drew a check to the Chase National Bank for account of the Second National Bank of Houston* for the difference between the amount of the first credit and the amount of the second credit. In drawing the check it obviously was recognizing the validity of the assignment of the first credit by Refiner's Export Company to the Second National Bank of Houston. No other theory can justify its failure to make the check payable to Refiner's Export Company.

Two days later it received the missing documents. It, thereupon, clearly became liable for payment under its first letter unless the action of the beneficiary in assigning proceeds constituted a violation of the credit by virtue of incorporation of Article 49 into its terms which would excuse honor. The conduct of New York Trust Company makes this defense unavailable to it, but is its customer equally bound? If the answer is yes, can the customer recover from New York Trust for breach of fiduciary duty?

At the trial, the argument used by New York Trust Company was that it had never "transferred" the first letter within the meaning of old Article 49, but had merely issued letters of credit back to back, the technical but mercantilely important difference, I take it, being the retention of Refiner's Export Company as prime beneficiary. The court did not consider the facts demonstrating the existence of an assignment of the original credit for security and the recognition of that assignment by New York Trust Company by payment to the assignee. Nor did the court pay any attention to the assignment of proceeds of the second letter to Manufacturer's Trust. In accordance with decent commercial needs, it held all the transactions proper and refused to allow the original customer to recover against New York Trust on any theory.¹³⁰ The court relied heavily on testimony that the practice of back-to-back credits was well established in New York and that "transfer" in Article 49 had to be read against that background of practice. The thing that is extraordinary to me is that the draftsmen of new Article 49, even after the experience of this case, failed to

¹³⁰ Obviously, if Article 49 includes assignment of proceeds, the New York Trust Company acted in grossest breach of fiduciary duty.

draw any of the necessary distinctions found in Section 5-115 of the Code but allowed the Article to continue in hopeless confusion.¹³¹

The underlying sense of the court's decision in the *Kingdom of Sweden* case is, however, seriously threatened by the decision of the Appellate Division in *Eriksson v. Refiner's Export Co.*¹³² In that case New York Trust Company had also issued a letter of credit in favor of Refiner's Export Company on behalf of the Swedish government. Like the credit in the *Kingdom of Sweden* case it was confirmed, irrevocable, subject to the "Uniform Customs" and contained no negotiation clause. Refiner's Export Company assigned the proceeds to Cities Service for another debt instead of to a bank as security for the opening of a new credit.¹³³ It delivered to the New York Trust Company notice of the assignment and a draft drawn under the credit to its own order and endorsed to the order of Cities Service. The necessary documents under the credit were delivered to the bank at 11:20 A.M. on March 28, 1942, and the bank took them for examination. At noon the sheriff levied on them on behalf of an assignee of the Swedish government who had started suit against Refiner's Export Co. (a Texas corporation) for breach of the sales contract underlying the letters of credit in the *Kingdom of Sweden* case. There was a second levy after New York Trust Company had completed its check and found the documents to be complying. The court in an opinion showing little understanding of the commercial uses of letters of credit held "The letter of credit itself not being subject to assignment, the credit cannot be transferred by any assignment of a draft drawn against it."¹³⁴ It indicated the rule might well be otherwise if the credit were either a "general" one or contained a negotiation clause. It thought that the purpose of Article 49 "is to prevent a special letter of credit from becoming general merely by some form of transfer."¹³⁵ It, therefore, sustained the attachment. The lower court had shown more sense.

Of course, these two cases in New York when read against the practice of back-to-back credits, the commercial needs of the community and the language of the new Article 49 may make the law of New York clear, settled and known to New York bank counsel and to the New York Law Revision Commission, but I confess to being left in a great state of wonder, for if the rule of the *Eriksson* case had been applied to the *Kingdom of Sweden* case, there is no doubt New York Trust Company, despite testimony as to back-to-back credit practice, would have been liable for breach of fiduciary duty to its customer.

¹³¹ Perhaps the law is not as well known as the New York Law Revision Committee believes.

¹³² 264 App. Div. 525, 35 N.Y. S. 2d 829 (1st Dep't, 1942) to which *Warren v. Chemical Bank & Trust Co.*, 274 App. Div. 785, 79 N.Y.S. 2d 776 (1st Dep't, 1948) adds its own note of confusion.

¹³³ The two transactions were not related as in *Kingdom of Sweden v. N.Y. Trust Co.*, 197 Misc. 451, 96 N.Y.S. 2d 779 (S. Ct., 1949) and in that sense the case is not as typical.

¹³⁴ *Eriksson v. Refiner's Export Co.*, 264 App. Div. 525, 527-28, 35 N.Y. S. 2d 829, 832 (1st Dep't, 1942).

¹³⁵ *Ibid.*, at 528, 833. What are back-to-back credits but another form of the same thing?

Use of the letter of credit by foreign-beneficiaries for further financing of themselves with consequent similarity of problem to that created by American use is reflected in *Pintel v. R.N.A. Mohamed & Bros.*¹³⁶ There the Citizens Nat'l Trust & Savings Bank of Los Angeles had issued a credit to a beneficiary called Mohamed. It, too, was a "special" credit in the sense that it was addressed to him alone. The opinion is silent as to whether it contained a "subject to Uniform Customs" clause.¹³⁷ It did contain a negotiation clause. It also provided for bills of lading to be drawn to the order of the issuer.¹³⁸ Mohamed drew a draft payable to his financier, the Mercantile Bank of India, and negotiated it to that bank in Ceylon. As in the *Eriksson* case, the proceeds of the credit were attached by a creditor of the beneficiary when the draft and documents were presented for payment in California by the Mercantile Bank of India. The court allowed the Mercantile Bank to prevail. It pointed out that the negotiation clause brought into play the Negotiable Instruments Law and that under that law the draft was a negotiable instrument like a check, and the Mercantile Bank was owner of the check because it had allowed full drawings against it.¹³⁹ The court felt itself bound by the law of Ceylon, the place of transfer, whose law it found to be like American law in that it did permit acquisition of title to the draft by the Mercantile Bank. The decision distinguishes the *Eriksson* case on the ground that in that case no negotiation clause was present in the credit. If this is a valid ground of distinction, and it arguably is, Article 49 in the future should be construed as repugnant to a negotiation clause and, therefore, superseded by such a clause.

The failure of Article 49 to draw the necessary distinctions, both as to type of credit (straight or negotiable) and as to type of situation (drawing or proceeds or novation or type of performance) is one basic reason for the confusion which has started to develop in the courts and which will undoubtedly continue to develop in the absence of some clarifying statutory rule. The Code solution would be improved, in my opinion, by restricting the issuing bank's general option to honor drafts despite notice of assignment of proceeds (Section 5-115 [2]) to cases where the credit contained a negotiation clause. In all other cases, I believe, the issuer should honor the notice of assignment of proceeds. The security of back-to-back credits is no better than the validity of the assignment of proceeds of the original credit, even where the same bank issues both credits, if we look at the problem as one involving perfection of right by the bank as

¹³⁶ 107 Cal. App. 2d 558, 237 Pac. 315 (1951); see also *Johnson v. Comtoir Franco Belge D'Exportation*, 135 Cal. App. 2d 683, 288 P. 2d 151 (1955) and *Westminster Bank Ltd. v. Arlington Overseas Trading Co.*, 1 Ll. L. Law Rep. 211 (K.B., 1952) on the kind of situation that can arise.

¹³⁷ It probably did not. This bank's forms are in our analysis of forms.

¹³⁸ The essential repugnancy of this clause to the negotiation clause was urged on the court.

¹³⁹ The argument that the Mercantile Bank was not a holder in due course was deemed irrelevant.

against the seller-beneficiary's creditors. Without such perfection, Section 60(a) of the Bankruptcy Act is on hand to plague us.

The problem of transferability of credits is one of the most troubling ones in today's use of credits.¹⁴⁰ Practically and mercantilely speaking, the problem must be solved by allowing use of the letter for seller-beneficiary financing. The testimony of the experts in *Kingdom of Sweden* indicates that the force of mercantile need has already gone a long way to permit such use despite the contrary tendency of Article 49 of the "Uniform Customs" and the doubtful validity of the assignments of the proceeds of the credits under New York law.¹⁴¹ I recommend earnestly that Article 49 be dropped from the "Uniform Customs" before it results in making back-to-back credits so legally insecure as to curtail their use.

Documentary Compliance: Excuse from Honor

The major area in which the "Uniform Customs" could really be extremely useful is in the area of describing what kinds of documents "comply" with the terms of a letter of credit, in other words, especially in the area of interpretation, the necessarily shorthand language of the credit. This is the area in which practice should be left free to develop in accordance with changing commercial need and usage.

The most important documents and the ones customarily called for by the credit are the bill of lading, the insurance policy, and the commercial invoice.¹⁴² Uniformity of understanding and practice as to when these documents comply would go a long way to assure efficiency and clarity in international trade. Such uniformity, however, is obviously a long way off because it is precisely in these important areas that the American and British views diverge.¹⁴³ The descriptions in the "Uniform Customs" of complying documents are all, of course, subject to contrary specification by the customer. They are, therefore, in the nature of presumptions. As to these presumptions, banks have control over the situation only when they are the primary issuers. This control exists typically, in import credits, although there is a growing practice among American exporters to require issuance rather than confirmation of a credit by a named American bank. When an American bank advises or confirms a credit issued by a foreign bank, however, real trouble can develop as to matters about which the specifications of the credit are silent, and the presumptions indulged by the issuing foreign bank are different from those indulged by the confirming or advising American bank. Notwithstanding this difficulty, our survey of forms indicates

¹⁴⁰ See British worries, at note 125 supra.

¹⁴¹ The Eriksson case, in one sense, can be viewed as only a particular application of a general unwise New York policy against free assignability. See *Allhusen v. Caristo Construction Corp.*, 303 N.Y. 446, 103 N.E. 2d 891 (1952).

¹⁴² This is recognized by Article 15 of the "Uniform Customs," Section 2-320 of the Code, the American Foreign Trade Definitions, 1941, and the Incoterms.

¹⁴³ Britain and the United States are the major nations issuing letters of credit.

that it is precisely in the area of export credits that greatest uniformity of incorporation of the "Uniform Customs" appears.¹⁴⁴ It is important, therefore, to contrast the "Uniform Customs" and British presumptions in at least some of their more commercially significant detail.

| Uniform Customs | British |
|--|--|
| "Received for shipment" or "Alongside" bills of lading O.K. ¹⁴⁵ | "On board" or "Shipped" bills required. ¹⁴⁶ |
| Certain "Through" bills O.K. ¹⁴⁷ | No "Through bills" accepted. ¹⁴⁸ |
| "Certificates" of insurance O.K. ¹⁴⁹ | Only "policies" of insurance are acceptable. ¹⁵⁰ |
| 3% deviation on quantity O.K. in named circumstances. ¹⁵¹ | No rule of thumb, matter dependent on mercantile facts. ¹⁵² |
| "Partial shipments" permitted. ¹⁵³ | Partial shipments not permitted. ¹⁵⁴ |
| "Prompt" shipment means 30 days. ¹⁵⁵ | "Prompt" means next steamer unless circumstances indicate the contrary. ¹⁵⁶ |
| Terms such as "first half," "second half" of a month given precise meaning. ¹⁵⁷ | Given meaning dependent upon the circumstances. ¹⁵⁸ |

So far as the "Uniform Customs" include "Received for shipment" bills and "Alongside" bills, they do reflect the American export practice and point of view.¹⁵⁹ The British view represents a dominantly import practice. I suspect that the divergence in practice originates in divergence in the shipping background of the two nations. American steamers leaving American ports typically follow regular schedules. This regularity of schedule makes possible relatively easy computation of the probable time of arrival of the goods which are delivered to the dock. Irregular or non-scheduled sailings, typical of many of the freighters serving the British Commonwealth even today, much less in the past, afford no such relatively reliable base for computing arrival. Yet knowledge of arrival dates is essential to merchants. This difference, therefore, seems to be slated to continue.

So, too, the differences on insurance certificates which are called "brokers

¹⁴⁴ Consult text at notes 36, 37. This apparently is the result also found by the New York Law Revision Commission's questionnaire.

¹⁴⁵ Article 19.

¹⁴⁶ Documentary Credits, 165 *the Banker's Magazine* 23, 24 (1948).

¹⁴⁷ Article 19.

¹⁵⁰ *Op. cit. supra* note 146.

¹⁴⁸ *Op. cit. supra* note 146.

¹⁵¹ Article 35.

¹⁴⁹ Article 15.

¹⁵² *Op. cit. supra* note 146.

¹⁵³ Article 36.

¹⁵⁴ Rice and Thorne, *The Uniform Customs and Practices for Commercial Documentary Credits*, 56 *The Canadian Banker* 53, 57 (1949).

¹⁵⁵ Article 42.

¹⁵⁷ Articles 46 and 47.

¹⁵⁶ *Op. cit. supra* note 146.

¹⁵⁸ *Op. cit. supra* note 146.

¹⁵⁹ Consult American Foreign Trade Terms—1941; Section 2-323(1) of the Code.

notes" by the British¹⁶⁰ seem to me to be slated to continue since they rest on different insurance practices.

The difference on presumptive permission of "partial shipments" is of a different character. The sales presumption, both American and British, is in favor of the British view.¹⁶¹ But the sales presumption is easily rebuttable by a showing of circumstances in the seller's position which makes it unreasonable to get all the goods aboard a single vessel. In support of the "Uniform Customs" presumption it can be argued that foreign trade is typically in the kind of goods and under circumstances which rebut the normal sales presumption and that no banker can be asked to judge such circumstances at his peril.¹⁶² The British answer is that British bankers are willing to assume this burden since they feel its assumption to be a real service to their customers.¹⁶³

The "Uniform Customs" presumption as to permissible partial shipment, however, is not only general but covers and is applicable even to situations where the credit names a vessel.¹⁶⁴ The naming of a vessel has only one commercial meaning; full shipment is required on that vessel. We have here a situation where a position which was debatable but commercially defensible has without reason been extended to include a situation for which no commercially sound reason exists.¹⁶⁵

The other differences listed above reflect the basic difference between the "Uniform Customs" attitude and the British attitude—willingness to assume responsibility for commercial judgment and need. In each case the "Uniform Customs" have adopted a rule of thumb at the extreme edge of commercial tolerance. In each case, the British rely on their own knowledge and judgment of the commercially reasonable:

No such tolerance [3% margin on shipment] is normally permitted here [England], although a small over or under shipment might be permitted, if the bank were satisfied of its necessity. . . . Most British banks would require shipment by the first available steamer after establishment of a credit. There is, however, no hard and fast rule on this subject in this country, and each individual case must be judged on its merits and according to the circumstances. . . . Articles 46 and 47 provide exact days to cover such terms as "First half" or "Second half" of a month, "beginning,"

¹⁶⁰ Consult American Foreign Trade Terms—1941; Section 2-320(2)(c) of the Code for the American view; Rice and Thorne, *op. cit.* supra note 154 at 57 for the British view.

¹⁶¹ Uniform Sales Act § 45; Sales of Goods Act § 31; Code § 2-307.

¹⁶² This argument is made by K. N. Llewellyn. At least eleven of the import and export sales form contracts of Trade Associations show that partial shipment is envisaged. Only nine negate or are silent on this point. Classification by import and export shows no significant differences on this point.

¹⁶³ *Op. cit.* supra note 146 at 26.

¹⁶⁴ Article 36 reads "... even though the credit mentions the name of a vessel. . . ."

¹⁶⁵ The original Article 36 read "Banks may refuse to pay for partial shipments if they think it advisable." It was superseded by American Guiding Provision 4 as adopted in 1938 (consult Ward and Harfield 197), which in due course, as redrafted, became Article 36 of the "Uniform Customs."

"middle" or "end" of a month. . . . Banks here would not consider themselves bound under such terms, to any specified period and, here again, experience and the circumstances of each individual case would guide the decision.¹⁶⁶

This is not to say that the "Uniform Customs" sections on what constitutes compliance are not useful. Many of them are very helpful on recurrent problems and represent a mercantilely reasonable interpretation.¹⁶⁷ The important thing is to recognize that some areas of compliance are suited to regulation by "custom," whereas others require a solid legal base.

The issue of documentary compliance can arise either in suits by the beneficiary against the issuer on the latter's duty to honor the drafts and documents presented under the credit or it may arise in actions by the issuer against its customer for reimbursement after honor or by the customer against the issuer for damages suffered as a result of the issuer's acceptance of non-complying documents. In the group of cases involving actions between customer and issuer, there can also be involved questions of discrepancy between the obligation assumed by the issuer under the customer's application agreement and the obligations assumed by the issuer on the letter of credit. Obviously if the two are not the same, in an action involving customer and issuer, the customer's application will be deemed controlling.¹⁶⁸

Another difference in issue can arise between the group of cases dealing with actions by beneficiaries against issuers and the group of cases dealing with actions between customers and issuers. That issue is whether or not good faith action by the issuer in honoring documents which in fact do not comply with the credit is binding upon the customer so that the issuer may either require reimbursement or successfully defend itself in an action by the customer for acceptance or honor of wrong documents. On the beneficiary end, the issue is whether or not bona fide purchasers from the beneficiary can enforce honor in situations where the beneficiary could not.

The only sections of the Code which presently deal with these problems are Section 5-107 on duty to honor and Section 5-111 on excuse from honor or reimbursement. As the New York Law Revision Commission has pointed out, Section 5-111 is inadequate in failing to provide explicitly what the obligation to honor of the issuer is when the beneficiary himself presents drafts or documents which are forged or fraudulent and the issuer knows of the fact of forgery or fraud. I suggest that Section 5-111 be amended to provide for excuse from honor under such circumstances so that this matter can be clarified.

It is particularly important to achieve statutory clarification of the relation-

¹⁶⁶ Op. cit. supra note 146 at 24-25.

¹⁶⁷ Consult e.g., Article 18 on "clean" shipping documents; Article 17 on proof of payment of freight; Articles 20, 21 and 22 on non-acceptability of certain bills of lading; Article 23 on the effect of an "on board" notation; Article 28 on the currency in which insurance must be issued; and Article 29 on its amount.

¹⁶⁸ This points up the necessity for consistency between the two contracts, a consistency which is not always apparent in the bank forms.

ships of the parties involved in a letter-of-credit transaction when fraudulent or forged documents are presented under the letter of credit since the case law on this subject in New York and elsewhere is confused and uncertain. There are three different types of fraud or forgery which can be involved in the situation. The first and most obvious of course is the forged signature of the beneficiary as drawer of the draft under the credit. Nobody has ever contended that the issuer is not responsible for such a forgery and none of the exculpatory clauses appearing in the customer's application agreements indicate any desire on the part of the banks to be relieved of this basic banking risk.¹⁶⁹ The next type of forgery which can be involved is that of the bill of lading or other document of title. No carrier or bailee has in fact issued it. This is an extremely important matter because this is the document which carries title to the goods. If the document is forged, which in essence means that no carrier or bailee has ever received the goods then of course the very purpose of the sale and of the issuance of the letter of credit as a payment device under the sales transaction fails. Recognizing this essential nature of a document of title it has been held that a warehouse receipt which is forged is not "a warehouse receipt"¹⁷⁰ entitling the holder to reimbursement. The matter however has been complicated by the fact that a forged bill of lading may look regular upon its face and therefore may have been negotiated in good faith by a negotiating bank or honored by the issuer itself. It seems reasonably clear that such good faith should be protected.¹⁷¹ Since the situation is important and not passed upon in most jurisdictions, a statement in the Code is the only safe way of effecting the desired result. An issuer by statute should be told that he must refuse to honor against a document of title which he knows to be forged unless it is presented on behalf of what is essentially a holder in due course or a person to whom the bill has been duly negotiated.¹⁷²

The forgery of a document of title is not, however, the only way in which fraud occurs. Deliberate falsification or alteration of the date of shipment or other essential item could constitute fraud in the documents.¹⁷³ On the other hand, there has been some indication by way of dictum in *Sztejn v. Schroder Banking Corp.*¹⁷⁴ that a false date does not necessarily make the document fraudulent. This point should be clarified in the Code.

The third type of fraud or fraudulent conduct which can be involved in con-

¹⁶⁹ In fact this responsibility is one which is common to all banks in all transactions.

¹⁷⁰ *Old Colony Trust v. Lawyer's Title*, 297 Fed. 152 (C.A. 2d, 1924), cert. denied, 265 U.S. 585 (1923).

¹⁷¹ *Brown v. Rosenstein Co.*, 120 Misc. 787, 200 N.Y. Supp. 491 (S. Ct., 1923); *Havemeyer & Co. v. Exchange Nat'l Bank*, 293 Fed. 311 (C.A. 8th, 1923); *Bank of N.Y. & Trust Co. v. Atterbury Bros., Inc.*, 226 App. Div. 117, 234 N.Y. Supp. 442 (1st Dep't, 1929).

¹⁷² See Section 5-111 of the Code.

¹⁷³ See situations in *Bank of Taiwan v. Union Nat'l Bank*, 1 F. 2d 65 (C.A. 3d, 1924); *Williams Ice Cream Co. v. Chase Nat'l Bank*, 210 App. Div. 179, 205 N.Y. Supp. 446 (1st Dep't, 1934).

¹⁷⁴ 177 Misc. 719, 31 N.Y.S. 2d 631 (S. Ct., 1941).

nection with bills of lading is the shipment of rubbish instead of the goods called for. In this situation the courts have differed along the lines of policy highlighted by the dissenting opinion of Cardozo in *O'Meara Co. v. Nat'l Park Bank*¹⁷⁵ in 1925. Clarity requires statutory treatment.

Another important problem which can arise as to compliance is the extent to which the documents reflect difficulties and non-conformities in the goods themselves. It is at this point that the problem of what constitutes a "clean" bill of lading becomes material. The definition of the word "clean" is a matter which is peculiarly susceptible to custom and trade practice and the attempt of the "Uniform Customs" to at least give a preliminary definition of this term is very much a step in the right direction.¹⁷⁶ However, it is important that there be statutory recognition of the general principle that non-conformity of the goods is no reason for refusal to honor documents presented under a letter of credit. This general rule has been so often stated in the cases that it could have been thought of as a well-settled rule. Unfortunately, in a recent case in Oklahoma involving the Bank of America, the decision of the court raises doubt as to whether or not that rule is fully operative.¹⁷⁷ In view of the doubt engendered by that decision and by certain older cases,¹⁷⁸ it is important to have a clear statutory base establishing that non-conformity of the goods is no excuse for failure to honor a letter of credit.¹⁷⁹

Another problem of compliance which can be described as a problem of general fraud in the transaction itself is exemplified by *Asbury Park and Ocean Grove Bank v. The National City Bank*.¹⁸⁰

If the fraudulent beneficiary is the person presenting the documents, then the customer ought to be allowed to enjoin the issuer from honoring, and the issuer should be permitted on its own motion to refuse honor. If, on the other hand, the documents are being presented by a person to whom they have been duly negotiated, it seems reasonably clear that the documents must be honored by the issuer and that the issuer in turn should have reimbursement from the customer. In other words, the general Code rule as to fraud should be made applicable to this type of situation.

¹⁷⁵ 239 N.Y. 386, 146 N.E. 636 (1925). See *Bank of Montreal v. Recknagel*, 109 N.Y. 482 (1888); *Sztejn v. Schroder Banking Corp.*, 177 Misc. 719, 31 N.Y.S. 2d 631 (S. Ct., 1941).

¹⁷⁶ See Article 18.

¹⁷⁷ *Bank of America Nat'l Trust & Savings Ass'n v. Liberty National Bank & Trust Co.*, 116 F. Supp. 233 (W.D. Okla., 1953). (The view the court there took of what defects could have been perceived from the documents seems somewhat inconsistent with putting the risk of non-conformity on the customer-buyer.)

¹⁷⁸ *Renfrow v. Citizens State Bank of Stilesville*, 87 Ind. App. 318 (1927).

¹⁷⁹ The growing problem of arrival of goods before documents evidenced by individual bank forms of indemnity to carriers for release of the goods without surrender of the bill of lading makes it necessary to clearly negate non-conformity of the goods as a defense to honor.

¹⁸⁰ 35 N.Y.S. 2d 985 (S. Ct., 1942), aff'd 268 App. Div. 984, 52 N.Y.S. 2d 583 (1943). See also the court's suggestion of collusion between beneficiary and carrier in *Grob v. Manufacturer's Trust Co.*, 177 Misc. 45, 29 N.Y.S. 2d 916 (S. Ct., 1941).

A final question which needs codificatory treatment and on which the Code is at present silent is the question of what the bill of lading is to evidence and what additional matters may be evidenced by the commercial invoice. The important thing to note in this connection is that the bill of lading normally will describe the goods in terms of their general type. The letter of credit may, however, call for goods not only of the general type but of a particular kind within that type. Since it is of no concern to the carrier as to what kind the goods in the general type are this matter will rarely appear on the bill of lading. It should be declared by statute that the commercial invoice signed by the seller may supply the specification of kind within the type evidenced by the bill of lading and that this combination of invoice and bill of lading is compliance under a letter of credit calling for documents evidencing shipment of the particular kind of goods.¹⁸¹

In other words, in the area of compliance and duty to or excuse from honor, the difficulties in the New York cases, although not too great, and the relative absence of cases in other jurisdictions reflecting understanding of the basic problems of letter of credit, make imperative a statutory statement of general principle around which particular detail may be developed by custom in fact and "custom" in statement in the "Uniform Customs."

DOMESTIC USE OF LETTERS OF CREDIT

The most appalling myth which has been propagated of late and which has been indirectly accepted by the New York Law Revision Commission is that domestic use of letters of credit is a non-significant phase of total letter-of-credit operation and that this non-significance is apt to continue into the foreseeable future. This statement not only overlooks the fact that letters of credit developed in this country entirely out of domestic trade,¹⁸² but that the letter of credit is an inherently useful part of any trust-receipt transaction.

At the public hearings before the New York Law Revision Commission in Buffalo, it was explained to the Commission that the trust-receipt financing of

¹⁸¹ Statutory statement is important because despite the type of reading of documents done by the court in *Laudisi v. American Exchange National Bank*, 239 N.Y. 234, 146 N.E. 347 (1924), contrary readings are suggested by such cases as *Bank of N.Y. & Trust Co. v. Atterbury Bros., Inc.*, 226 App. Div. 117, 234 N.Y. Supp. 442 (1st Dep't, 1929). The sound policy in Article 33 of the "Uniform Customs" is not enough to control judicial action.

¹⁸² Consult Llewellyn's historical study in Ward and Harfield 68 et seq. We are newcomers only to the international scene. The origin in domestic use is further reflected in the banking laws of midwestern states. The following midwestern states give banks (or trust companies) power to issue letters of credit: Missouri, Mo. Stat. Ann. (Vernon, 1952) § 362.105; Mo. L. (1915) Art. II, § 66; Arkansas, Ark. Stat. Ann. (1947) § 67-538; Ark. Acts (1919) No. 339 § 4; Indiana, Ind. Stat. Ann. (Burns, 1950 Replacement) § 18-1103; Ind. Acts (1933) c. 40, Part IV Art. I, § 172; Oklahoma, Okla. Stat. (1951) Title 6, § 295, Okla. L. (1925) c. 56, § 3; South Dakota, S.D. Stat. Ann. (1939) § 6.0401, S.D.L. (1909) c. 22, Art. 2 § 4. Consult also for acceptance of time drafts, Iowa, Iowa Code (1954) § 528.71; Iowa Acts (1919) 38 G.A. c. 66, § 1; and Finkelstein, *Legal Aspects of Letters of Credit* 5 n. 7 et seq. (1930). I do not believe this power in the midwest was given to facilitate international trade.

automobiles by the Midland Trust involved the use of letters of credit.¹⁸³ It was also stated at that hearing that the business of that bank alone in domestic letters for wholesale automobile financing ran to several hundreds of millions of dollars per year. It was stated at the Buffalo hearings that this use of letters of credit for trust-receipt financing was not limited to the automobile but was being used extensively with respect to other commodities as to which no figures were apparently available. Examination of the cases involving letters of credit over the country indicates that automobiles are not the only commodity whose financing involves the use of letters of credit.¹⁸⁴ Major electrical appliances,¹⁸⁵ gas station equipment,¹⁸⁶ steel,¹⁸⁷ livestock,¹⁸⁸ mules,¹⁸⁹ and other produce¹⁹⁰ are also subject to this type of financing.¹⁹¹ The trading rules of the oilseed industry also call for domestic letters of credit.¹⁹²

Implicit in the notion of foreign trade as a prime source of letter-of-credit financing (which quite illogically is always thought to be a statement of the unimportance of domestic letters) is the idea that letters of credit are primarily issued by banks and cannot be issued or are not issued by finance companies and merchants. Again the cases, in their reflection of the actual economy of the nation, indicate that letters of credit were originally (and still are)¹⁹³ issued by merchants and that only as the banking and mercantile aspects of trade tended to go into specialty, did issue of letters tend to be by banking houses and ultimately by banks.¹⁹⁴ The vital thing to note is that any finance company in the country can and has issued letters of credit.

Domestic use of the credit occurs dominantly in two types of situation. The first is trust-receipt financing to enable purchase of goods, primarily "hard"

¹⁸³ N.Y. Law Revision Comm'n Study of Commercial Code, Leg. Doc. No. 65 (I) 48-49 (1954).

¹⁸⁴ Automobiles alone would be sufficient to take domestic letters out of the non-significant class. Over \$8,000,000,000 of such wholesale financing exists annually; and letter of credit followed by trust receipt was a familiar form at least as early as 1930, Finkelstein, *Legal Aspects of Commercial Letter of Credit* 24 (1930).

¹⁸⁵ See *Consolidated Sales Co. v. Bank of Hampton Roads*, 193 Va. 307, 68 S.E. 2d 652 (1952).

¹⁸⁶ See *Powerine Co. v. Russell's, Inc.*, 103 Utah 441, 135 P. 2d 906 (1943); *Powerine Co. v. Zion's Savings Bank & Trust Co.*, 106 Utah 384, 148 P. 2d 807 (1944).

¹⁸⁷ *Caloric Stove Corp. v. Chemical Bank & Trust Co.*, 205 F. 2d 492 (C.A. 1st, 1954).

¹⁸⁸ *Renfrow v. Citizens State Bank of Stilesville*, 87 Ind. App. 318 (1927).

¹⁸⁹ *Bank of Seneca v. First Nat'l Bank*, 105 Mo. App. 722, 78 S.W. 1092 (1904).

¹⁹⁰ *Bridge v. Welda State Bank*, 222 Mo. App. 586, 292 S.W. 1079 (1927).

¹⁹¹ The combined value of these goods far exceeds our foreign trade, so that even if letters of credit were used in only a small percentage of the financing of these goods the amount involved would still exceed the amount involved in foreign trade. Consult estimate that 90% of total letter-of-credit business is internal trade, which I personally find difficult to believe. *Letters of Credit Under the Proposed Uniform Commercial Code*, 62 Yale L.J. 227 at n. 1 (1953).

¹⁹² Consult the form contract of the Nat'l Institute of Oil Products (1952 Rev.).

¹⁹³ Consult guaranty cases cited note 119 supra.

¹⁹⁴ Ward and Harfield 69 et seq.

goods, from a manufacturer by a wholesaler or retailer.¹⁹⁵ The legal essence of the trust receipt is that title goes from the seller of goods to a third party (the financier) who in turn entrusts that title to the buyer for the purpose of sale and remittance of proceeds.¹⁹⁶ In jurisdictions which have not adopted the Uniform Trust Receipts Act, but have recognized the possibility of a common-law trust receipt, title *must*, for the validity of the lien, be obtained by the financing agency and then passed from it to its customer.¹⁹⁷ The most effective documentary proof of such passage of title is of course the letter of credit, since under that letter the drafts of the seller are drawn upon the financier and title to the documents is transferred to the financier on honor of the drafts.

In addition to trust-receipt financing, letters of credit can play an effective role in certain types of agricultural financing. The so-called "Red clause" found in Asiatic trade¹⁹⁸ has its domestic counterpart. Letters of credit have been used for the purpose of enabling an agent to buy up grain, livestock or the like.¹⁹⁹ I do not believe that this type of financing is any longer being done on any really large scale in this country, but its use cannot be dismissed as wholly non-significant.

I think that the misapprehension as to the domestic use of letters of credit stems out of the fact that in that use there has been no such necessity as has appeared in the international field by virtue of the conflict of laws and practices which exist between nations to chart out elaborate rules of procedure and understanding and to develop relatively stereotyped forms. Nor did we enter that field suddenly as we did the international area.

The fact is, however, that in domestic commerce, as in international commerce, the letter of credit is being used as (1) a means of securing payment to the seller, (2) affording the wherewithal of bank or finance company financing

¹⁹⁵ Trust-receipt financing is also a dominant pattern of buyer financing in foreign trade on the import side. This is reflected not only in the cases but in the bank application for credit forms. Many of these provide not only that the documents which are sent forward with the draft in an import credit are to be taken by the bank as security for the customer's payment, but that these documents will be released to the customer on trust receipt. Some of the forms also insert a clause by which the customer promises to give a trust receipt. In jurisdictions in which the Uniform Trust Receipts Act has been adopted, this agreement to give a trust receipt is the equivalent of a trust receipt even though there be no further signing by the customer of a trust-receipt form. Uniform Trust Receipts Act § 2 (Sub 1. 11).

¹⁹⁶ Under the Uniform Trust Receipts Act, it is not essential that title not be in the buyer prior to its being in the bank. Under that act, a security interest may simultaneously or promptly go into the bank and into the buyer, and may even go into the bank by virtue of exhibition of the documents to the bank by the buyer.

¹⁹⁷ See *Farmers & Mechanics Nat'l Bank v. Logan*, 74 N.Y. 568 (1878); *Drexel v. Pease*, 133 N.Y. 129 (1892); *Moors v. Kidder*, 106 N.Y. 23 (1887).

¹⁹⁸ Consult the discussion in Ward and Harfield 132-36, and in Shaterian, *Export-Import Banking* 340-44 (1947).

¹⁹⁹ See e.g., *Renfrow v. Citizens State Bank of Stilesville*, 87 Ind. App. 318 (1927); *Bank of Seneca v. First Nat'l Bank*, 105 Mo. App. 722, 78 S.W. 1092 (1904).

of the buyer by trust receipt and (3) providing the seller with a prime asset for use in his own financing.²⁰⁰

It is curious to me, too, that a group generally as astute to cross article implications as the New York Law Revision Commission is could approve the priority sections of Article 9 of the Code dealing with secured transactions without perceiving the relationship of those sections to the use, and probably expanded use, of domestic letters of credit. I repeat again that the use of letters of credit and the right to issue them are not limited to bankers and never have been.²⁰¹

Briefly stated, the priority sections of Article 9 have as one basic policy that "purchase money security interests" shall be prior to security interests which are filed earlier but arise on the same goods by virtue of an after-acquired-property clause. The simplest and easiest way to police the use of funds for payment of the purchase price of new goods is of course the letter of credit. I would be greatly surprised if general adoption of Article 9 of the Code did not lead to expanded use of letters of credit by persons other than banks. It seems to me that well-advised finance companies would certainly issue promises to honor drafts accompanied by documents in all cases where documentary shipment is possible whenever they wish to be certain of acquiring a purchase money security interest which could then be proved as to date and use of funds by way of documents alone.²⁰²

Since letters of credit are being used domestically today in various important lines of trade, and since it seems inevitable that their use will increase with the adoption of Article 9 of the Code—perhaps the article most highly approved of all the articles in the Code by interests which have important legislative influence—there is a further problem existing in the present Article on letters of credit which should be corrected. Section 5-102(3) states: "In construing this Article reference may be had to uniform customs among banks." At the public hearings before the New York Law Revision Commission, some doubt was expressed as to whether this meant that the Code itself was to be construed in relation to uniform customs or whether it simply meant that bank customs and usages which fit the definition in Section 1-205 of the Code should be recognized in the construction of the conditions and phrases used in the contracts involved in a letter-of-credit transaction. There was also some suggestion at the public hearings that the language of Section 5-102(3) might be construed as embodying the "Uniform Customs." There certainly was no intention to

²⁰⁰ It apparently has not been realized that the growing practice of back-to-back credits more frequently than not involves both a domestic and a foreign credit.

²⁰¹ On the contrary there has from time to time been doubt about the right of national banks to issue sight letters of credit since in one sense the letter of credit is "a guaranty" and in another sense the sight letter of credit is not specifically authorized by the Federal Reserve Act.

²⁰² Documentary proof means summary judgment and is, therefore, of peculiar value.

incorporate the "Uniform Customs" in the Code.²⁰³ Whatever ambiguity may exist in the language is the result of hasty drafting in the summer of 1951. It seems to me that the desirable procedure is to eliminate Sub-section 3 in its entirety and thus permit letters of credit to develop and be construed precisely as other contracts under the Code develop and are construed in accordance with Section 1-205 of the Code.

A final problem of the Code Article on letters of credit is its failure to include clean credits. Not only are these used commercially in foreign trade,²⁰⁴ but they, too, can be used to assure proof of purchase money use of funds in situations where documentary shipment is not possible. The old provisions of the Negotiable Instruments Law on virtual and extrinsic acceptance²⁰⁵ have been eliminated from Article 3 of the Code and as a result, one major legal foundation for the enforceability of clean letters of credit is now gone. The code should be amended to take care of this lack.

Conclusion

The New York Law Revision Commission, in my opinion, is correct in many of its criticisms of particular sections of the letter-of-credit Article of the Code. That Article has other defects which the Commission has not perceived. But defects of drafting or of policy should not blind us to the basic non-uniformity, confusion and, for jurisdictions other than New York, virtual "case-lessness" of the field. The letter of credit is a most useful financing device but one which is generally unknown to the bar. Only by a uniform statute will its services become truly available to the country at large. The letter-of-credit transaction is also closely linked in practice and in policy with sales and secured financing. It requires treatment in a Code which also deals with these areas of commerce. The myths of existing uniformity and certainty in the field are only myths. They should finally be put to rest, and in their place a solid statutory base should come into operation.

²⁰³ The Chief Reporter of the Code in presenting Article 5 in September, 1951, explicitly disclaimed any such intention.

²⁰⁴ *American Nat'l Bank & Trust Co. v. Banco Nacional de Nicaragua*, 231 Ala. 614, 166 So. 8 (1936).

²⁰⁵ Sections 134 and 135.